Supreme Court, U.S.
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IN THE

Supreme Court of the United States

NATIONAL HERITAGE INSURANCE COMPANY,

Petitioner,

v.

UNITED STATES EX REL. TONI R. BARRON AND VICKY SCHEEL,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether the Fifth Circuit erred by applying a test designed to determine a *public* entity's "arm of the state" immunity to a *private* corporate entity, thereby widening a circuit split that now includes the Fifth, Ninth, and Eleventh Circuits.

II. Whether the Fifth Circuit erred by establishing a state treasury test that conflicts with this Court's precedent and with decisions of the Fourth and Eleventh Circuits.

INTERESTED PARTIES AND 29.6 STATEMENT

The following listed persons and entities have an interest in the outcome of this case.

Defendant-Petitioner

National Heritage Insurance Company (wholly owned by Electronic Data Systems Corporation, a public corporation traded on the New York Stock Exchange)

Relators-Respondents

Toni R. Barron
Vicky Scheel

United States-Respondent

Paul D. Clement

Defendants-Respondents

Deloitte & Touche, L.L.P.
Deloitte & Touche Consulting Group, L.L.C.
Deloitte & Touche Consulting Group Holding, L.L.C.

Defendant-Respondent

Medicaid Claim Solutions of Texas

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Petitioner, National Heritage Insurance Corporation ("NHIC") respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on August 11, 2004.

OPINIONS BELOW

The opinion of the Fifth Circuit is reported at 381 F.3d 438 and is reproduced in the appendix hereto. (Appendix A) (hereinafter "App."). The decision of the District Court and the Findings and Recommendations of the Magistrate Judge are unreported and are reprinted in the appendix. (App. B and C, respectively). The order of the Fifth Circuit denying NHIC's petition for *en banc* or panel rehearing is reprinted in the appendix. (App.. D).

STATEMENT OF JURISDICTION

The opinion of the court of appeals was entered on August 11, 2004. Petitioner timely sought panel or *en banc* rehearing, which the Fifth Circuit denied on December 9, 2004. (App. D). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

U.S. Constitution, Amendment 11:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

STATEMENT OF THE CASE

This Petition presents an important issue of first impression to this Court, over which the federal courts of appeals are divided: when does a private corporation acting on behalf of a state become "an arm of the state" for Eleventh Amendment immunity purposes? The Petition also urges review of a novel test adopted by the Fifth Circuit that all but requires that the state itself be directly liable for a judgment before the "effect on a state's treasury" is deemed sufficient to warrant a grant of Eleventh Amendment immunity to a private corporate entity. The Fifth Circuit's new test conflicts with precedent of this Court as well as decisions of the courts of appeals for the Fourth and Eleventh Circuits.

Respondents Toni R. Barron and Vicky Scheel ("Relators"), filed this *qui tam* action under the False Claims Act, 28 U.S.C. § 3729 *et seq.* ("FCA"), against NHIC, Deloitte & Touche, L.L.P, Deloitte & Touche Consulting Group, LLC, Deloitte & Touche Consulting Group Holding, LLC ("Deloitte"), and Medicaid Claim Solutions of Texas. Relators' claims arise out of the School Health and Related Services ("SHARS") program in Texas, which is part of the Medicaid Program operated by the State of Texas (the "Texas Medicaid Program"). The Relators are therapists who purportedly worked with students receiving services from the SHARS program. (Record at 4, 535) (hereinafter referred to as "R."). Their suit claims that, in the course of providing SHARS services, Deloitte and Medicaid Claim Solutions were enlisting SHARS providers to improperly bill services to the SHARS program. (R. at 1-23, 532-82).

NHIC was sued solely in its capacity as the claims administrator for the Texas Medicaid Program. Texas law allows the Texas Department of Human Services to use "any fiscal intermediary" to pay claims made under the Texas Medicaid Program. *See* TEX. HUM. RES. CODE ANN. § 32.029(b) (Vernon 1997). In this statutory role, NHIC processes and pays Medicaid claims on behalf of the State of Texas in accordance with explicit rules and regulations promulgated by the State and federal government that leaves nothing to NHIC's discretion. (R. at 183). NHIC's role with respect to the SHARS Program is to pay claims for services rendered to students by eligible providers pursuant to guidelines and rates set by the State. The providers, not NHIC, certify that they have complied with all of the requirements of the SHARS program when they request payment.

It is undisputed that NHIC does not set Medicaid rates or establish any of the rules or regulations governing the SHARS Program, and that at all times material to Relators' claims, NHIC was acting under the direction and supervision of the State agencies that regulate the SHARS Program. (R. at 182-83). Nor is there any allegation in Relators' complaint that NHIC acted in contravention of any policies, procedures, or directions issued by the State of Texas with respect to the operation of the SHARS Program. (R. at 183, 409-17). In fact, Relators' first Complaint repeatedly referred to NHIC and the State of Texas collectively. (Respondents' Record Excerpts Tab 6).

NHIC moved to be dismissed from Relators' lawsuit on immunity grounds. On March 31, 2003, the District Court adopted the findings and recommendations of the Magistrate Judge dismissing Relators' case in its entirety. (App. at 16a-17a). In his findings and recommendations, the Magistrate

Judge ruled that NHIC was entitled to Eleventh Amendment immunity as an arm of the State of Texas. (App. at 45a-53a). The Magistrate Judge reached this conclusion based on NHIC's relationship with the State of Texas and the Texas Medicaid Program, focusing on the following determinative facts:

(1) NHIC derived its authority to act from the Texas Human Resources Code and its services contract with the State of Texas;

(2) a judgment against NHIC for services performed in its role as a Medicaid fiscal intermediary would affect the treasury of the State of Texas;

(3) the conduct of NHIC was controlled by the State of Texas, and NHIC "does not exercise any autonomy or discretion of its own in [the distribution of Medicaid funds];" and

(4) NHIC performed its services for the benefit of the whole State of Texas.

(App. at 48a-52a).

Relators subsequently appealed the District Court's order and judgment adopting the Magistrate Judge's report and recommendation. On appeal, the Fifth Circuit reversed the District Court's judgment, holding that because the State of Texas was not a named party in the litigation and the State of Texas would not be required to indemnify NHIC for any judgment against it, the state treasury was not sufficiently affected to warrant a finding that NHIC was an arm of the State of Texas. (App. at 3a-5a).

REASONS FOR GRANTING THE PETITION

Medicaid is a $300 billion a year program that involves tens of thousands of service providers and serves roughly 50 million people.[1] Few if any states have the administrative skill or resources to operate this important program without assistance, so they delegate their state functions and authority to private companies to be exercised pursuant to explicit state guidelines. But as states increasingly turn some of their duties and obligations (like Medicaid) over to private companies, one important aspect of that relationship is more uncertain than ever: When does a corporate entity implementing the state's programs enjoy the immunity of the state?

Almost thirty years ago, this Court held that a *public* entity which qualified as an arm of the state could "partak[e] of the State's Eleventh Amendment immunity." *Mt. Healthy City Sch. Dist. Bd. of Educ. v. Doyle*, 429 U.S. 274, 281 (1977). With additional guidance from such cases as *Regents of the University of California v. Doe*, 519 U.S. 425, 429-30 (1997)[2], the courts of appeals have attempted to develop

1. *See, e.g.*, Bret Schulte, *Taking on a Budget-Busting Mess*, U.S. News & World Report, Feb. 21, 2005, at 38.

2. *Regents* noted that the Court "sometimes examined 'the essential nature and effect of the proceeding,' . . . and sometimes focused on the 'nature of the entity created by state law' to determine whether it should 'be treated as an arm of the State.'" *Regents of the Univ. of Cal. v. Doe*, 519 U.S. 425, 429-30 (1997) (internal citations omitted). Additionally, in *Regents*, the Court said that "the question of whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued." *Id.* at 430 (citing *Hess v. Port Auth. Trans-Hudson Corp.*, 513 U.S. 30, 45-51 (1994)).

similar approaches for determining the right of a *public* entity to invoke a state's Eleventh Amendment immunity.[3]

But in the context of a *private* corporate entity, a multi-circuit conflict exists with respect to the proper test that should be used to determine when the private entity is entitled to invoke the State's Eleventh Amendment immunity. *Compare United States ex rel. Barron v. Deloitte & Touche*, (App. A), 381 F.3d 438 (5thCir. 2004), and *United States ex rel. Ali v. Daniel, Mann, Johnson & Mendenhall*, 355 F.3d 1140, 1147 (9th Cir. 2004), *with Shands Teaching Hosp. and Clinics, Inc. v. Beech St. Corp.*, 208 F.3d 1308 (11th Cir. 2000). This Court has never addressed that specific question. As a result, conflict prevails among the decisions of the courts of appeals. The Fifth and the Ninth Circuits squarely conflict with the Eleventh Circuit's position on this important constitutional question.

The uncertainty and confusion surrounding the correct approach for determining whether and when a private corporate entity may invoke a state's Eleventh Amendment immunity places considerable strain on states and their current and would-be corporate agents. Who, if anyone, bears

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3. *See, e.g., Clissuras v. City Univ. of New York*, 359 F.3d 79, 82 (2d Cir. 2004) (two-factor test) (citing *Pikulin v. City Univ. of New York*, 176 F.3d 598, 600 (2d Cir. 1999)); *Vierling v. Celebrity Cruises, Inc.*, 339 F.3d 1309 (11th Cir. 2003) (three-factor test); *Wojcik v. Massachusetts State Lottery Comm'n*, 300 F.3d 92 (1st Cir. 2002) (seven-factor test); *Clark v. Tarrant County*, 798 F.2d 736 (5th Cir. 1986) (six-factor test). Although these tests generally attempt to incorporate similar factors, such as the source of the entity's funding, whether state law views the entity as an arm of the state or not, and the degree of control exercised by the state over the entity, the actual tests applied by many of the courts of appeal in practice are quite different. *See* Sections I & II, *infra.*

risk of suit, what principles govern the analysis, how should the contract be structured to utilize the principles, and how can any such risk be allocated? In this unsettled context, what kind of premium must a state pay in order to attract potential Medicaid administrators to the table, and how does that affect the administration of Medicaid? Given the extant conflicts, will corporate agents do business with states in some circuits but not in others? The answers profoundly affect the way states and their corporate agents administer Medicaid and other state and federal programs. This Court can and should issue a writ of certiorari to review the opinion of the Fifth Circuit and provide the guidance that is greatly needed in this important area of the law.

I. A Direct Conflict Exists in the Circuit Courts Regarding the Proper Test to Determine Whether a Private Entity is Entitled to Eleventh Amendment Immunity as an "Arm of the State."

In this case, the Fifth Circuit applied its six-factor *public* entity test to determine whether NHIC, a *private* corporate entity, was an arm of the state. The factors applied below were: (1) whether the state statutes and case law view the entity as an arm of the state; (2) the source of the entity's funding; (3) the entity's degree of local autonomy; (4) whether the entity is concerned primarily with local, as opposed to statewide, problems; (5) whether the entity has the authority to sue and be sued in its own name; and (6) whether the entity has the right to hold and use property. *See Barron*, (App. at 3a), 381 F.3d at 440 (citing *Hudson v. City of New Orleans*, 174 F.3d 677, 679 (5th Cir. 1999)). The Ninth Circuit also has applied its public entity arm of the state inquiry to determine whether a private corporation is an arm of the state for Eleventh Amendment immunity purposes. *See Ali*, 355 F.3d at 1147.

The Eleventh Circuit, on the other hand, has expressly refused to apply its public entity analysis to private corporate entities. *See Shands*, 208 F.3d 1308.[4] *Shands* involved a suit brought by a hospital network that provided medical services to employees of the State of Florida under the State's self-funded health benefits plan against two private corporations – one that contracted with the State of Florida to act as a third party administrator of the State's self-funded employee health benefits plan, and another that worked for the third party administrator as a subcontractor. *See id.* at 1309-10. The plaintiff argued that the corporations did not qualify as arms of the State because they were not directly controlled by the State and did not derive their funding from the State. *See id.* at 1311.

The Eleventh Circuit concluded that the plaintiff's argument "misse[d] the mark." The proper inquiry, the court held, was not into "the nature of a corporation's status in the abstract, but its function or role in a particular context." *Id.* Thus, the court held that the outcome of the case depended on whether and to what extent the private corporations were contractually acting as representatives of the State, and that

> the dispositive question for Eleventh Amendment purposes is whether a judgment against [the defendants] would implicate the state treasury *or* interfere with the administration of the state group insurance program, or whether the claims constitute a private cause of action, arising out of tort or contract, for which [the defendants] would be financially responsible.

Id. (emphasis added).

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4. The fact that the *Shands* court applied a different test to a private entity is highlighted by the fact that the court continues to apply its traditional multi-factor test to *public* entities. *See Vierling*, 339 F.3d at 1314 (holding that the traditional multi-factor arm of the state test is applied to determine whether a state agency or instrumentality may invoke the state's immunity).

It is far more logical to apply the *Shands* test to a private corporate entity than to apply the public entity test used by the Fifth Circuit in the case below. As the Fifth Circuit itself acknowledged, at least two of the six public entity factors are difficult if not impossible to evaluate in the context of a private corporation, *Barron*, (App. at 6a-7a), 381 F.3d at 441-42 ("the entity's degree of local autonomy" and "the entity's concern with local, as opposed to statewide, problems"), while two others – the authority to sue and be sued and the ability to hold and use property – are largely meaningless to the inquiry because *every* private corporation presumably will have such authority. It was this difficulty which led the Eleventh Circuit in *Shands* to state that "the pertinent inquiry is not into the nature of a corporation's status in the abstract, but its function or role in a particular context." *Shands*, 208 F.3d at 1311.

Forcing the public entity framework on private corporate entities, as the Fifth Circuit did, conflicts with the Eleventh Circuit's more pragmatic and realistic approach. The difference is not theoretical. NHIC plainly would have enjoyed Eleventh Amendment immunity as an arm of the state in the Eleventh Circuit, yet it is has no such immunity in the Fifth Circuit.

Imposing the public entity analytical framework in the context of a private corporate entity hardly provides any clarity, and, in fact, only entrenches existing circuit conflicts. The Fifth Circuit and other courts disagree both as to the factors to apply to an entity asserting arm of the state immunity as well as to the relative importance of those factors.

This Court's decisions in *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30 (1994), and *Regents of the University of California* attempted to clarify this area of the law, but the law is still quite fractured. In *Regents of the University of California*, the Court stated that "the question of whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued." *Regents*, 429 U.S. at 430. *Regents* followed, and affirmed, the Court's holding in *Hess* that "the vulnerability of the State's purse [is] the most salient factor in Eleventh Amendment determinations." *Hess*, 513 U.S. at 48. As noted by the Sixth Circuit, the collective result of these two cases is that "the *Hess* opinion focused on the impact on a state treasury, and [*Regents v.*] *Doe* slightly altered that emphasis by establishing that *potential liability, not actual ability to pay or indemnification*, determines the Eleventh Amendment status of an entity." *Brotherton v. Cleveland*, 173 F.3d 552, 560-61 (6th Cir. 1999) (emphasis added).

While the Sixth Circuit emphasized the Supreme Court's focus on issues which impact the state treasury, the Fourth Circuit found *Regents'* language concerning an entity's treatment by state law to be significant as well. *See Cash v. Granville County Bd. of Educ.*, 242 F.3d 219 (4th Cir. 2001). In *Cash*, the court held that an entity could enjoy Eleventh Amendment immunity as an arm of the state even where the state treasury would not be affected by an adverse judgment when "the judgment would adversely affect the dignity of the State as a soverign and as one of the United States. . . . Under this inquiry, factors formed largely to determine the 'relationship between the State and the entity in question' . . . become relevant." *Id.* at 224 (*quoting Regents*, 519 U.S. at 429).

Here, the Fifth Circuit purported to analyze NHIC's status under the traditional six-factor public entity analysis. But as the language of the opinion makes clear, the court ultimately relied on one – and only one—factor in reaching the decision that "the source of the entity's funding . . . is the weightiest factor, and *it is controlling here*." *Barron*, (App. at 3a), 381 F.3d at 440 (emphasis added). The court's admission that this so-called "state treasury" factor controlled its analysis underscores the conflict in the courts of appeals with respect to the tests properly used to determine whether a private entity is entitled to invoke a state's Eleventh Amendment immunity.

Recent decisions of the Sixth and Fourth Circuits provide an excellent illustration of the present conflict that exists between the circuits. In *Ernst v. Roberts*, 379 F.3d 373, 382 (6th Cir. 2004), *reh'g granted* (Nov. 17, 2004)[5], the court discussed the collective result of its arm of the state rulings since *Hess* and *Regents*, reaching the following conclusion:

> [i]n light of the statements [in the Sixth Circuit's recent arm of the state cases] indicating that *Hess* may have completely eliminated any consideration of other factors, we reiterate the position taken in those cases: potential liability of the state treasury is the most important factor, and the other factors may have been rendered completely obsolete by Hess.

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5. Although the Sixth Circuit has decided to rehear this case *en banc*, NHIC cites the opinion only for the purposes of discussing the summary of the circuit's law as explained in the opinion. The fact that the court has decided to rehear the case *en banc* demonstrates the uncertainty of arm of the state jurisprudence even within individual circuits, let alone between the circuits.

The Sixth Circuit acknowledged that when the parties present no evidence on the state treasury factor, "other factors may be considered." *Id.* Nevertheless, the court reiterated its holding, noting that "it is unclear whether other factors may even be considered when evidence is presented regarding whether the state treasury will be liable for a judgment." *Id.*

The Fourth Circuit employs a test dramatically different from the Fifth and Sixth Circuits in determining whether an entity is entitled to immunity as an arm of the state. To be sure, the Fourth Circuit places emphasis on the state treasury factor, holding that "if the State treasury will be called upon to pay the judgment against a government entity, then Eleventh Amendment immunity applies to that entity, and consideration of any other factor becomes unnecessary." *Cash*, 242 F.3d at 223.

But the converse is not true. The court explicitly held that when the state treasury will not be affected by a judgment, "the entity may still enjoy sovereign immunity if the judgment would adversely affect the dignity of the State as a sovereign and as one of the Untied States." *Id.* at 224. In order to determine whether an entity is an arm of the state under this additional "state dignity" analysis, the Fourth Circuit looks to three additional factors: (1) the degree of control that the state exercises over the entity or the degree of autonomy from the state enjoyed by the entity; (2) whether the entity is concerned with matters on a state or local scale; and (3) the manner in which state law treats the entity. *See id.* It is obvious that the Fifth Circuit's test could not be more divergent from the one employed by the Fourth Circuit, and that this conflict directly affects NHIC's ability to invoke Eleventh Amendment immunity.

Other circuit courts have developed additional variations of the arm of the state inquiry. The Second Circuit, for example, has held that six factors are to be considered in determining whether an entity is an arm of the state: (1) how the entity is referred to in its documents of origin; (2) how the entity's governing members are appointed; (3) how the entity is funded; (4) whether the entity's function is concerned with state or local governmental matters; (5) whether the state has veto power over the entity's actions; and (6) whether the entity's fiscal obligations are binding upon the state. *See McGinty v. New York*, 251 F.3d 84, 95 (2d Cir. 2001). The court stated that

> [i]f these factors point in one direction, the inquiry is complete. If not, a court must ask whether a suit against the entity in federal court would threaten the integrity of the state and expose its treasury to risk. If the answer is still in doubt, a concern for the state fisc will control.

Id. at 96 (internal citations omitted).

The test applied by the Tenth Circuit is a two-part inquiry resembling that of the Second Circuit. *First*, the court examines the degree of autonomy enjoyed by the entity, "as determined by the characterization of the agency by state law and the extent of guidance and control exercised by the state. *Second*, the court examines the extent of financing the agency receives independent of the state treasury and its ability to provide for its own financing." *Sturdevant v. Paulsen*, 218 F.3d 1160, 1164 (10th Cir. 2000). "The ... entity is immune from suit if the money judgment sought is to be satisfied out of the state treasury." *Id.*

Collectively, these tests demonstrate that, from circuit to circuit, an entity may face markedly different requirements to invoke arm of the state immunity. There is no doubt that the tests of the circuit courts, including those applied by the Fifth Circuit in this case and the Eleventh Circuit in *Shands*, are in direct conflict. This conflict alone merits the issuance of writ of certiorari to resolve this vital constitutional issue.

II. The Novel Test Developed by the Fifth Circuit to Determine When a Judgment Impacts the State Treasury for Eleventh Amendment Purposes Conflicts with Decisions both of this Court and Other Circuit Courts.

The inapplicability of the Fifth Circuit's multi-factor public entity test to NHIC forced the court to, in effect, create a one-factor test for corporate entities.[6] The court held that the indemnity clause[7] between NHIC and the State of Texas, which obligated NHIC to pay any judgments assessed against the State resulting from NHIC's performance, "conclusively establishes that Texas will suffer *no legal liability* for any

6. While the Fifth Circuit purported to make the "source of the entity's funding" the dispositive question, *Barron*, (App. at 3a), 381 F.3d at 440 ("the source of the entity's funding . . . is the weightiest factor, and it is controlling here."), the court actually created a novel, and very narrow, indemnity test. Indeed, had the court actually analyzed the *source* of NHIC's funding it would have found that NHIC exists solely to administer Medicaid and Medicare programs, and that it is funded solely by Medicaid and Medicare funds.

7. Without discussing the merits of the Fifth Circuit's holding as to the meaning of the indemnity clause, NHIC notes that it does not agree with the Fifth Circuit's interpretation of the clause, and no statement in this Petition is intended to constitute a waiver of NHIC's position with respect to the meaning of that clause.

damages assessed against NHIC." *Barron*, (App. at 4a), 381 F.3d at 440 n.7. The court went on to state that its "inquiry about a judgment's effect on state treasuries does not extend to suppositions about whether NHIC will . . . pay its judgment from funds derived from the state for performing its contractual obligations." *Id.*, (App. at 4a-5a), 381 F.3d at 441 n.8. Thus, the court held, NHIC could not claim Eleventh Amendment immunity as an arm of the State of Texas because (1) the State of Texas would neither be directly liable for a judgment nor required to indemnify NHIC for a judgment against it, and (2) the State would not be responsible for "NHIC's general debts and obligations." *Id.* (App. at 4a), 381 F.3d at 440.[8]

The Fifth Circuit's narrow indemnity-centered test squarely conflicts with this Court's Eleventh Amendment jurisprudence. In the public entity context, the Court has made clear that "the question whether a money judgment against a state instrumentality or official would be enforceable against the State is of considerable importance to any evaluation of the relationship between the State and the entity or individual being sued," *Regents*, 519 U.S. at 430, and that if a state is obligated to bear and pay the indebtedness of an entity whose

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8. In relying on these factors, the Fifth Circuit cited its decision in *Hudson v. City of New Orleans*, 174 F.3d 677 (5th Cir. 1999), where it held that the state treasury factor was determined by "first and most importantly, the state's liability in the event there is a judgment against the defendant, and second, the state's liability for the defendant's general debts and obligations." *Id.* at 687 (*citing Jacinoport Corp. v. Greater Baton Rouge Port Comm'n*, 762 F.2d 435, 441 (5th Cir. 1985)). Of course, the *Jacinoport* case on which *Hudson* relied predated this Court's decisions in *Regents of the University of California* and *Hess*, which substantially broadened the analysis of the state treasury test.

expenditures exceed its receipts, *either legally or practically*, the core concern of the Eleventh Amendment is implicated. *Hess*, 513 U.S. at 51. The Court also observed in *Regents* that "it is the entity's *potential legal liability*, rather than its ability or inability to require a third party to reimburse it, or discharge the liability in the first instance, that is relevant" for Eleventh Amendment purposes. *Regents*, 519 U.S. at 431 (emphasis added).

The Fifth Circuit's test defies the principles laid out by this Court that it is the state's potential liability, in a legal or practical sense, that matters, not the mere presence or absence of an indemnity agreement between a state and a private entity charged with carrying out traditional governmental functions. As currently formulated, the Fifth Circuit's test leads to the irrational conclusion that Relators can directly sue the fiscal intermediary of a state without running afoul of the Eleventh Amendment as long as the intermediary has agreed to indemnify the State for any resulting judgment.

The legal and practical impact of such a decision on the state treasury can hardly be overstated. The Texas Human Resources Code expressly allows the State to determine whether, as a financial matter, it is better off using its own staff to perform claims payment under the Texas Medicaid Program, or whether it should contract with an outside company such as NHIC to do so. TEX. HUM. RES. CODE ANN. § 32.029(b) (Vernon 1997). The Fifth Circuit's holding in this case – that a private corporation responsible for administering a traditional governmental program on behalf of the State is not entitled to immunity unless the State is obligated to pay a judgment against the entity – will deter private corporations from serving in such a role.

Indeed, if the Fifth Circuit's holding in this case is allowed to stand, private corporations such as NHIC will be nothing more than guarantors for the State's alleged misconduct, bearing risks out of proportion to any potential remuneration under the contract. The inevitable result is that a private entity will refuse to perform the State's administrative duties at all, or will charge the State a substantial premium for doing so. The State in turn may find itself administering the program, which would require the expenditure of additional state resources, or paying a private entity significantly more money to perform the same functions as those performed by NHIC under its contract with the State. In either event, it is clear that the orderly administration of the Texas Medicaid Program and the security of the state's treasury would be impacted if NHIC is not entitled to invoke the State's Eleventh Amendment immunity as an arm of the state.[9]

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9. Indeed, the Fifth Circuit's narrow test completely ignores the impact of a finding that the procedures the State required NHIC to follow were not in compliance with federal Medicaid guidelines. While the Department of Health and Human Services (and the Centers for Medicare and Medicaid Services ("CMS")) can audit states for compliance, *see, e.g.*, 42 C.F.R. § 430.33, if a court were to find that the State-mandated procedures NHIC followed were erroneous, the CMS might use such a finding in the administrative process to cut the funding of the Texas Medicaid Program. *See id.* §§ 430.35, 430.45. The impact of such efforts on the state fisc and the administration of Medicaid would be enormous. If Relators and the government wish to attack Texas' Medicaid procedures, they should follow the administrative process outlined in detail in the Code of Federal Regulations, so Texas will at least have the chance to defend its practices before having its funding impacted (and without being required to waive its immunity by intervening in this suit).

In addition to conflicting with decisions of this Court, the Fifth Circuit's indemnity test also conflicts with the tests adopted in other circuits. In *Shands*, for example, the Eleventh Circuit *refused* to limit its immunity analysis to the following facts, all of which are likewise present in this case: (1) the State was not a named party to the litigation; (2) the State was not required to indemnify the private contractor which was a party to the suit; and (3) the defendant private contractor was required to indemnify the State for any judgments against it arising out of the performance of its duties under its contract with the State. *Shands*, 208 F.3d at 1313. Instead, the court looked to the nature of the relationship between the private corporation and the State to determine whether the corporation was entitled to Eleventh Amendment immunity as an arm of the state:

> [u]nder the laws of Florida and the contractual provisions between the parties, it is clear that [the defendants] are simply administrators acting at the behest of the State with reference to Florida's health insurance program. The program is funded through annual legislative appropriations, and the State of Florida retains virtually complete control over the actions of its administrators.

Id. at 1311.

Thus, the Eleventh Circuit held that a declaratory judgment against the defendants in *Shands* would impermissibly implicate state funds and interfere with the administration of the state's health insurance program because the judgment "would ultimately affect the state treasury, insofar as the state insurance fund would be obligated to increase payouts on the number of covered

services," and "[a]ny analysis by the court of the State's obligations under the various contractual provisions would impermissibly intrude upon the future administration of the state program." *Id.* The court also held that the plaintiff's claim for damages based on the defendants' nonpayment of medical claims submitted by the plaintiff implicated state funds because the contract between the plaintiff and the defendants "provide[d] that the penalty for the failure to reimburse claims within thirty days is payment of the full amount of the claims. Such payment for medical services rendered is an obligation of the State." *Id.* at 1313. Accordingly, although the plaintiff only sought damages from the defendants, and not the state of Florida, the fact that the damages at issue were based on obligations of the state sufficiently implicated state funds to permit the private contractor to invoke the state's Eleventh Amendment immunity.

Since the decisions of this Court in *Hess* and *Regents*, other circuit courts in addition to the Eleventh Circuit have developed "state treasury" analyses that do not focus on the immediate, direct liabilities faced by states, but instead properly hinge on states' potential legal liabilities. For example, in *Ristow v. South Carolina Ports Authority*, 58 F.3d 1051 (4th Cir. 1995), *cert. denied*, 516 U.S. 987 (1995), an opinion issued after the Court remanded the case to the Fourth Circuit for decision in light of *Hess*, the court applied the state treasury factor with an emphasis on the *practical* effects of a judgment against an entity asserting arm of the state immunity. The court held that "[i]t is true that a judgment against the Ports Authority cannot be legally enforced against the state. The *practical effect* of South Carolina's treatment of the fiscal affairs of the Ports Authority, however, *definitively implicates* the state treasury."

Id. at 1054 (emphasis added). The court held that because the state "provides whatever economic support is necessary over and above the Port Authority's net revenues to insure its continued vitality," a "judgment against the Ports Authority involves the 'core concern' of the Eleventh Amendment – the ebb and flow of funds into and out of South Carolina's treasury." *Id.*

Instead of analyzing the extent to which the State of Texas could be exposed to any potential legal liabilities in connection with the administration of the Texas Medicaid Program or evaluating the extent to which the treasury would be affected either legally or practically as a result of a judgment against NHIC, the Fifth Circuit wrongly concluded that the only legal liability worth considering was an adverse judgment that the State itself would be required to pay. Because such a narrow test can only be said to focus on the state's *actual* liabilities, the court's decision conflicts with decisions of the Eleventh Circuit, the Fourth Circuit, and, most importantly, this Court. *See Regents*, 519 U.S. at 431; *Hess*, 513 U.S. at 51; *Shands*, 208 F.3d at 1311, 1313; *Ristow*, 58 F.3d at 1054.

The effect of the Fifth Circuit's test is that immunity will not lie even where, as here, all of the funding derives from the State, all of the activities are inherently governmental, the activities are wholly controlled by the State, and a judgment against the administrator of the State's Medicaid program would interfere with the administration of the program. The conflict between the circuits on this issue is one of paramount importance, and it merits resolution by this Court.

CONCLUSION

Petitioner respectfully requests that the Court issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT FILED AUGUST 11, 2004

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 03-50507

UNITED STATES of America, ex rel., Toni R. BARRON; Vicky J. Scheel,

Plaintiffs-Appellants,

versus

DELOITTE & TOUCHE, L.L.P.; Deloitte & Touche Consulting Group, L.L.C.; DELOITTE & TOUCHE CONSULTING GROUP HOLDING, L.L.C.; MEDICAID CLAIM SOLUTIONS OF TEXAS, INC.; NATIONAL HERITAGE INSURANCE CO.,

Defendants-Appellees.

Appeal from the United States District Court for the Western District of Texas

Before KING, Chief Judge, and REAVLEY and EMILIO M. GARZA, Circuit Judges.

REAVLEY, Circuit Judge:

This is a qui tam action under the False Claims Act, 31 U.S.C. § 3729, against National Heritage Insurance

Company ("NHIC"), Deloitte & Touche, and Medicaid Claim Solutions of Texas (collectively, "Defendants"). Toni Barron and Vicky Scheel ("Relators") assert that Defendants participated in the knowing submission to the United States of false claims for Medicaid reimbursement. Relators, who are both medical professionals, maintain that they learned of Defendants' false claims in the course of providing therapeutic services to students in several Texas public school districts. According to Relators, consultants from both Deloitte and Medicaid Solutions alerted local school districts to the opportunity to gain reimbursement through Medicaid for health services that the districts were already providing. Those consultants also allegedly instructed the districts to maximize their recovery through improper billing practices. Relators further aver that NHIC, which processes claims and distributes federal Medicaid funds for the State of Texas, acquiesced in the fraudulent billing practices described in the complaint. The district court concluded that any action arising out of NHIC's role as a Medicaid fiscal intermediary is barred by Texas's Eleventh Amendment immunity. We disagree.[1]

This court reviews the issue of Eleventh Amendment immunity *de novo*. *Cozzo v. Tangipahoa Parish Council—President Gov't*.[2] In order to determine whether the district court properly concluded that NHIC is an arm of the state

1. In an accompanying unpublished disposition, we reverse the district court's dismissal of Relators' claims against Defendants under the public-disclosure bar of the False Claims Act.

2. 279 F.3d 273, 280 (5th Cir.2002).

and thus entitled to sovereign immunity from this damages action, we employ a six factor test:

> 1. Whether the state statutes and case law view the agency as an arm of the state;
>
> 2. The source of the entity's funding;
>
> 3. The entity's degree of local autonomy;
>
> 4. Whether the entity is concerned primarily with local as opposed to statewide, problems;
>
> 5. Whether the entity has the authority to sue and be sued in its own name;
>
> 6. Whether the entity has the right to hold and use property.

Hudson v. City of New Orleans.[3] This *Clark* test seeks to determine "if the state is the real, substantial party in interest because the suit seeks to impose a liability which must be paid from public funds in the state treasury."[4]

The second *Clark* factor—the source of the entity's funding—is the weightiest factor, and it is controlling here. *See Vogt v. Bd. of Comm'rs*.[5] The Eleventh Amendment exists

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3. 174 F.3d 677, 679 (5th Cir.1999) (summarizing six factor test developed in *Clark v. Tarrant County*, 798 F.2d 736, 744-45 (5th Cir.1986)).

4. *Hudson*, 174 F.3d at 681 (internal citation and quotation marks omitted).

5. 294 F.3d 684, 693 (5th Cir.2002).

mainly to protect state treasuries. *See id.* To determine if the state treasury is being protected, this court looks first to whether the state would be liable for a judgment against the defendant and then to whether the state would be liable for the defendant's "general debts and obligations." *Hudson.*[6] In this case, the state is neither directly responsible for a judgment, nor would it indemnify the defendant. The contract between NHIC and the State of Texas resolves the matter because it dictates that NHIC is to pay its own judgments and indemnify the State from any liability.[7] Additionally, the parties do not contend that the State is responsible for NHIC's general debts and obligations. This court's inquiry about a

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6. 174 F.3d at 687.

7. The contract states:

> To the extent authorized by law, [NHIC], as an independent contractor, agrees to hold STATE AGENCY and its board members, contractors, subcontractors, independent consultants and their subcontractors and consultants and/or federal government harmless and to indemnify them from any and all liability, suits, claims, losses, damages and judgments, and shall pay all costs, fees and damages to the extent that such costs, fees and damages arise solely from performance or non-performance of CONTRACTOR under this Contract.

NHIC responds by pointing out that, under the parties' contract, it is not required to indemnify the State for losses caused by its prudent conduct in conformity with instructions given by the State. Even so, the aspect of the contract that is significant for the *Clark* analysis is NHIC's obligation to pay any damages resulting from its performance. This clause conclusively establishes that Texas will suffer *no legal liability* for any damages assessed against NHIC.

judgment's effect on state treasuries does not extend to suppositions about whether NHIC will: (1) pay its judgment from funds derived from the state for performing its contractual obligations; (2) attempt to pass on future litigation costs to the state through higher prices; or (3) demand future indemnification agreements or contribution to future judgments. *See Williams v. Dallas Area Rapid Transit*[8]; *Pendergrass v. Greater New Orleans Expressway Comm'n*[9]; *see also United States ex rel. Ali v. Daniel, Mann, Johnson & Mendenhall.*[10]

Turning to the other *Clark* factors, the court is to look at how state statutes and case law characterize NHIC. Texas law does authorize the Texas Department of Health to "use any fiscal intermediary" to assist in the administration of federally authorized medical-assistance programs. Tex. Hum. Res.Code Ann. § 32.029(b) (Vernon 2001). But no indicia

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8. 242 F.3d 315, 319 (5th Cir.2001) (stating that "we do not consider a state's voluntary, after-the-fact payment of a judgment to be a liability against the state's treasury").

9. 144 F.3d 342, 346 (5th Cir.1998) (finding the second *Clark* factor to weigh heavily against immunity when the state would not pay the judgment and the possible loss of surplus funds to the state to be "too indirect and too remote to characterize it as a potential liability of the state treasury or to make the state the real, substantial party in interest.").

10. 355 F.3d 1140, 1147 (9th Cir.2004) (denying Eleventh Amendment immunity to a private contractor in part because there was no evidence that the state university that hired the contractor would have "a legal obligation to pay a judgment against" the contractor).

of state law—"constitution, laws, judicial opinions, attorney general's opinions, [or] other official statements"[11]—identify NHIC as something other than a purely private corporation. In particular, there is no state case law identifying NHIC as an arm of the state. *See Jacintoport Corp. v. Greater Baton Rouge Port Com'n.*[12]

The third *Clark* factor, the entity's degree of local autonomy, is difficult to evaluate in the context of a private corporation. Most "arm of the state" cases address the distinction between local and state control. *See, e.g., Minton v. St. Bernard Parish Sch. Bd.*[13] NHIC has little discretion in executing its contract with the State; the State provides NHIC with specific instructions on how to pay Medicaid claims for the school-based health services that are at issue in this case. Yet, NHIC is an autonomous entity; the State neither appoints nor approves of NHIC's board of directors or its corporate officers. *Cf. Delahoussaye v. City of New Iberia.*[14] Moreover, to determine an entity's autonomy, this court is directed to look at the " 'extent of the [entity's] independent management authority,' not just the independence of the

11. *Hudson*, 174 F.3d at 683.

12. 762 F.2d 435, 439 (5th Cir.1985) (focusing on state cases as a determinative inquiry under the Eleventh Amendment).

13. 803 F.2d 129, 131-32 (5th Cir.1986) (emphasizing school boards' discretion in "performing their functions and addressing their innately local concerns").

14. 937 F.2d 144, 148 (5th Cir.1991) (finding this factor points toward immunity when the state appoints members of the organization as well as supervises and manages the entity's functions).

individual [board members]." *Jacintoport Corp.*[15] As a private corporation, NHIC has the independent authority to make internal decisions about compensation and the authority to contract for needed services. Additionally, even if we were to conclude this factor weighed in favor of NHIC's immunity, control is not a dispositive factor. *See Hess v. Port Auth. Trans-Hudson Corp.*[16]

The fourth *Clark* factor, the entity's concern with "local, as opposed to statewide, problems,"[17] is also difficult to assess for a private corporation. The usual test is "whether the entity acts for the benefit and welfare of the state as a whole or for the special advantage of local inhabitants." *Pendergrass.*[18] In acting as Texas's claim administrator, NHIC demonstrates a concern for a statewide rather than local problem. But, of course, private corporations operate for the benefit of their investors, rather than the State. *See generally* Tex. Bus. Corp. Act Ann. art. 13.06 § A (Vernon 2003); *Dunagan v. Bushey.*[19]

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15. 762 F.2d at 442.

16. 513 U.S. 30, 48 (1994) (explaining that "rendering control dispositive does not home in on the impetus for the Eleventh Amendment: the prevention of federal-court judgments that must be paid out of a State's treasury").

17. *Clark,* 798 F.2d at 745.

18. 144 F.3d at 347.

19. 263 S.W.2d 148, 152 (Tex. 1953) ("The directors of a corporation stand in a fiduciary relationship to the corporation and its stockholders, and they are without authority to act as such in a matter in which a director's interest is adverse to that of the corporation.")

The last two *Clark* factors also weigh against granting immunity. NHIC has the "authority to sue and be sued in its own name" and may "hold and use property." *Clark*.[20]

We conclude that NHIC is not an arm of the State of Texas and is therefore not shielded by Eleventh Amendment immunity.

We observe, however, that several district courts have held NHIC to be an arm of the State of Texas. *See Texas Hosp. Ass'n v. National Heritage Ins. Co.;*[21] *United States ex rel. Churchill v. Texas;*[22] *United States v. Mack;*[23] *St. Joseph Hosp. v. Elec. Data Sys. Corp.*[24] These cases rely primarily on a combination of four arguments: (1) the requested or ultimate relief in a given case would be an increased outlay of Medicaid funds which would come directly from the State; (2) since some NHIC funds come from the State, the judgment is inevitably paid by the State; (3) all fiscal intermediaries are immune under Fifth Circuit precedent; and (4) NHIC's lack of discretion renders it an agent of the State. We do not find these arguments to be persuasive.

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20. 798 F.2d at 745.

21. 802 F.Supp. 1507, 1512 (W.D.Tex.1992).

22. 2000 WL 33706360, at *6 (W.D.Tex. Nov.15, 2000).

23. 48 F.Supp.2d 708, 713-14 (S.D.Tex.1999).

24. 573 F.Supp. 443, 449-50 (S.D.Tex.1983).

First, some of the decisions rely in part on the fact that the relief requested by the plaintiffs would involve an increased outlay of Medicaid funds coming directly from the State. *See Churchill;*[25] *see also Texas Hosp. Ass'n.*[26] But, here, the requested damages sought by Relators would not come from Medicaid outlays; those damages would be paid by NHIC from its corporate funds.[27]

A second (related) line of reasoning contends that NHIC should be granted immunity simply because it might use funds earned through its contract with the State to pay any damages award. *Churchill;*[28] *Mack.*[29] Accepting this argument

25. 2000 WL 33706360 at *4.

26. 802 F.Supp. at 1512.

27. Both the *Churchill* and *Texas Hospital Ass'n* courts also assert that NHIC is entitled to immunity because a judgment against it would require Texas officials to take certain actions to comply with federal law. *See Churchill,* 2000 WL 33706360, at *5; *Tex. Hosp. Ass'n,* 802 F.Supp. at 1512. But, under the doctrine of *Ex parte Young,* 209 U.S. 123 (1908), the Eleventh Amendment does not bar suits seeking to compel state officers to comply prospectively with the requirements of federal law, even when the costs of those prospective compliance efforts could be quite high. *See Quern v. Jordan,* 440 U.S. 332, 337 (1979). Thus, even if we were to treat NHIC like a state official (as it maintains we should do), established principles of state-sovereign immunity would permit an award of relief affecting the future administration of Texas's Medicaid program.

28. 2000 WL 33706360 at *5.

29. 48 F.Supp.2d at 713 ("[A]n award of damages against NHIC would be paid out of funds NHIC receives from the State of Texas. Put another way, NHIC would not be in a position to be sued by [plaintiff] if it was not paid by the State of Texas to run the state's Medicaid program.")

would convert all private contractors, not just fiscal intermediaries, into immune agents whenever they are doing work for the State. In addition, as we explained above, the prospective impact on the state's treasury is not the same as the *Clark* inquiry into direct implications for the state fisc.

Another ground offered in favor of immunity relies on Fifth Circuit precedent where *Medicare* fiscal intermediaries are entitled to federal immunity.[30] *See Matranga v. Travelers Ins. Co.*;[31] *Peterson v. Blue Cross/Blue Shield of Texas*;[32] *Peterson v. Weinberger.*[33] In *Weinberger* (the case on which *Matranga* and *Blue Cross/Blue Shield* depend), the fiscal intermediaries in question were governed by regulations that provided that "[i]n the performance of their contractual undertakings, the carriers act on behalf of the Secretary, carrying on for him the administrative responsibilities imposed by law. The Secretary, however, is *the real party in interest* in the administration of the program. . . ." 20 C.F.R. § 405.670 (1973) (emphasis added). There is no similar state regulation here to make Texas the real party in interest in this suit against NHIC, a *Medicaid* fiscal intermediary.

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30. This view is taken in *Mack*, 48 F.Supp.2d at 713-14; *Texas Hosp. Ass'n*, 802 F.Supp. at 1512; *St. Joseph's Hosp.*, 573 F.Supp. at 450.

31. 563 F.2d 677, 677 (5th Cir.1977) (per curiam).

32. 508 F.2d 55, 57-58 (5th Cir.1975).

33. 508 F.2d 45, 51-52 (5th Cir.1975).

Two district court cases rely on a fourth rationale, holding that, since NHIC lacked discretion and acted as an "agent of the state," it should be immune. *Texas Hosp. Ass'n;*[34] *St. Joseph's Hosp.*[35] NHIC presses this reasoning, arguing that it should be immune from damages just like a state agent or a state employee sued in her official capacity. We are not persuaded. An individual state officer sued in her official capacity for damages is entitled to Eleventh Amendment immunity precisely because the state that employs her is the real party in interest. But, when an entity (as opposed to an individual) is the defendant, the *Clark* analysis conducted above is designed specifically to determine whether a suit against that entity is, in fact, one against the state itself. *See Daniel, Mann, Johnson & Mendenhall.*[36] And, here, that analysis reveals that Texas is not the real party in interest in Relators' action against NHIC.[37]

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34. 802 F.Supp. at 1512.

35. 573 F.Supp. at 450.

36. 355 F.3d at 1147 (holding that the "arm of the state" test for sovereign immunity is the proper analysis to be undertaken in determining whether a private contractor is immune from suit under False Claims Act).

37. We also note that performance of state functions alone is insufficient to create immunity. Indeed, the Supreme Court has demonstrated its willingness to allow disparate treatment for state and private employees performing the same functions. *See Richardson v. McKnight,* 521 U.S. 399, 413 (1997) (holding that employees of private prisons are not entitled to qualified immunity in § 1983 suits, even though employees of state-run prisons do enjoy that immunity).

(Cont'd)

Nevertheless, NHIC urges us to follow the Eleventh Circuit's decision in *Shands Teaching Hospital & Clinics, Inc. v. Beech Street Corp.*[38] *Shands* held that Eleventh Amendment immunity precluded a hospital's state-law claims against two private contractors—an administrator for Florida's employee health plan and a managed-care company that maintained a preferred-provider network for the plan—for declaratory relief and damages.[39] Although the court "found no case directly on point that has accorded Eleventh Amendment immunity to a private corporation," it granted the defendants immunity nonetheless, relying on cases extending federal sovereign immunity to *Medicare* fiscal intermediaries.[40] Further, the court emphasized that the contract between the hospital and the State, under which the hospital agreed to provide care for state employees, "expressly provides that the penalty for the failure to reimburse claims within thirty days is payment of the full amount of the claims. Such payment for medical services rendered is an obligation of the state."[41] Thus, in *Shands*,

(Cont'd)

While *Richardson* was concerned with the lack of governmental control over private prisons, the Court stressed that the bar against suing individuals in their official capacities is designed to protect the state as the real party in interest.

38. 208 F.3d 1308 (11th Cir.2000).

39. *Id.* at 1312-13.

40. *Id.* at 1311. For the reasons discussed above, such cases are inapposite here.

41. *Id.* at 1313.

Florida would have been legally liable for any judgment rendered. By contrast, NHIC has not shown that Texas would bear any legal liability for any damages assessed against NHIC in this case.

Because NHIC has not shown that Texas would be subject to any legal liability for any damages assessed against it, we reverse the district court's judgment granting NHIC's motion to dismiss based on Eleventh Amendment immunity.

REVERSED and REMANDED.

APPENDIX B — ORDER ACCEPTING MEMORANDUM AND RECOMMENDATION OF THE UNITED STATES MAGISTRATE JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS, SAN ANTONIO DIVISION FILED MARCH 31, 2003

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION M

CIVIL ACTION NO. SA-99-CA-1093-FB

UNITED STATES OF AMERICA, ex rel TONI R. BARRON and VICKY SCHEEL,

Plaintiffs,

VS.

DELOITTE & TOUCHE, LLP., DELOITTE & TOUCHE CONSULTING GROUP, LLC., DELOITTE & TOUCHE CONSULTING GROUP HOLDING, LLC, MEDICAID SOLUTIONS OF TEXAS, and NATIONAL HERITAGE INSURANCE COMPANY

Defendants.

ORDER ACCEPTING MEMORANDUM AND RECOMMENDATION OF THE UNITED STATES MAGISTRATE JUDGE

The Court has considered the Memorandum and Recommendation of the United States Magistrate Judge filed in the above styled and numbered cause on September 9,

2002, Relators' Objections to the Memorandum and Recommendations Relating to Dismissal (docket #73), Defendant National Heritage Insurance Company's Response to Relator's Objections to the Magistrate's September 9, 2002 Report and Recommendation (docket #74), and Response Memorandum by Defendants Deloitte & Touche, L. L. P., Deloitte & Touche Consulting Group, L. L. C., and Deloitte & Touche Consulting Group Holding, L.L.C. to Relators' Objections to the Memorandum and Recommendations Related to Dismissal (docket #79). The Court has also reviewed the United States of America's Advisory to the Court (docket #72) as well as Relator's Advisory to the Court (docket #76).

Where no party has objected to a Magistrate Judge's Memorandum and Recommendation, the Court need not conduct a de novo review of them. *See* 28 U.S.C. § 636(b)(1) ("A judge of the court shall make a de novo determination of those portions of the report or specified proposed findings and recommendations to which objection is made."). In such cases, the Court need only review the Memorandum and Recommendation and determine whether they are either clearly erroneous or contrary to law. *United States v. Wilson*, 864 F.2d 1219, 1221 (5th Cir.), *cert. denied*, 492 U.S. 918 (1989).

On the other hand, any Memorandum or Recommendation to which there are objections requires de novo review by the Court. Such a review means that the Court will examine the entire record, and will make an independent assessment of the law. The Court need not, however, conduct a de novo review when the objections are frivolous,

conclusive, or general in nature. *Battle v. United States Parole Commission*, 834 F.2d 419, 421 (5th Cir. 1987).

The Court has reviewed the objections to the Memorandum and Recommendation along with defendants' responses and has conducted a de novo review of the Magistrate Judge's Memorandum and Recommendation. Based on the Memorandum and the Defendants' Responses (docket #s 74 & 79), the Court finds the objections to the Magistrate Judge's Recommendation are without merit. This Court hereby accepts, approves, and adopts the Magistrate Judge's factual findings and legal conclusions contained in the Memorandum and Recommendation issued September 9, 2002 (docket #70), and incorporates herein the arguments and authorities presented by the defendants in their respective responses. Therefore, the Memorandum and Recommendation shall be accepted pursuant to 28 U.S.C. § 636(b)(1) such the motion to dismiss based on lack of subject-matter jurisdiction filed by the Deloitte & Touche defendants should be granted; the motion to dismiss based on lack of subject jurisdiction and sovereign immunity filed by defendant National Heritage should be granted, and the complaint against defendant Medicaid Solutions of Texas should also be dismissed based on lack of subject matter jurisdiction.

Accordingly, it is hereby ORDERED that the Recommendation of the United States Magistrate Judge, filed in this case on September 9, 2002 (docket #70), is ACCEPTED such that the motion to dismiss based on lack of subject-matter jurisdiction filed by the Deloitte & Touche defendants (docket #18) is GRANTED; the motion to dismiss

based on lack of subject-matter jurisdiction and sovereign immunity filed by defendant National Heritage (docket #21) is GRANTED; the complaint against defendant Medicaid Solutions of Texas is DISMISSED based on lack of subject matter jurisdiction,[1] and this case is DISMISSED. Motions pending, if any are also DISMISSED.

It is so ORDERED.

SIGNED this 31st day of March, 2003.

s/ Fred Biery
FRED BIERY
UNITED STATES DISTRICT JUDGE

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1. As set forth in the Memorandum and Recommendation, defendant Medicaid Solutions of Texas did not file a dispositive motion. However, the Magistrate Judge found the tack of subject matter jurisdiction finding as to Deloitte & Touch and National Heritage also inures to the benefit of defendant Medicaid Solutions. The Court hereby accepts that recommendation as well.

APPENDIX C — MEMORANDUM AND RECOMMENDATION OF THE UNITED STATES MAGISTRATE JUDGE OF THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS, SAN ANTONIO DIVISION FILED SEPTEMBER 9, 2002

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS SAN ANTONIO DIVISION

CIVIL NO. SA-99-CA-1093-FH

UNITED STATES OF AMERICA ex rel TONI R. BARRON and VICKY SCHEEL

Plaintiffs,

DELOITTE & TOUCHE, LLP., DELOITTE & TOUCHE CONSULTING GROUP, LLC., DELOITTE & TOUCHE CONSULTING GROUP HOLDING, LLC., MEDICAID SOLUTIONS OF TEXAS, and NATIONAL HERITAGE INSURANCE COMPANY,

Defendants.

MEMORANDUM AND RECOMMENDATION

Before the Court are defendants Deloitte & Touche, LLP, Deloitte & Touche Consulting Group, LLC, Deloitte & Touche Consulting Group Holding LLC (hereafter collectively referred to as Deloitte & Touche) and National Heritage Insurance Company's (National Heritage) motions to dismiss. (Docket nos. 18 and 21). Relators, Toni Barron and Vicky Scheel (Barron and Scheel), have responded to each. (Docket nos. 51 and 61). The Court concludes Deloitte

& Touche's motion to dismiss should be **GRANTED** for lack of subject-matter jurisdiction, and National Heritage's motion to dismiss should be **GRANTED** based upon lack of subject-matter jurisdiction and sovereign immunity.[1]

Subject to this recommendation, this Court also concludes that, although service was improper, Deloitte & Touche's and National Heritage's motions to dismiss based upon insufficient service of process should be **DENIED**. Should the District Court reach this argument, Barron and Scheel should be allowed sufficient time to re-serve Deloitte & Touche and National Heritage. Alternatively, Deloitte & Touche and National Heritage contend Barron and Scheel failed to plead the fraud claim with sufficient particularity and move to dismiss on this basis. This Court declined to analyze this argument because Barron and Scheel have contemporaneously been granted leave to file an amended complaint. Deloitte & Touche and National Heritage also move to dismiss Barron and Scheel's complaint for failure to state a claim upon which relief can be granted. Should the District Court reach this argument, this Court concludes Deloitte & Touche's and National Heritage's motions to dismiss on this basis should be **DENIED**.

Factual Background

Barron and Scheel bring this *qui tam* lawsuit, on behalf of the United States of America, alleging causes of action

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1. Defendant Medicaid Solutions of Texas has not filed a dispositive motion. However, the finding that subject matter jurisdiction is lacking inures to that defendant's benefit as well. Therefore, Medicaid Solutions of Texas should also be dismissed as a defendant.

under the False Claims Act. Under the Individuals with Disabilities Education Act (IDEA), school districts must provide each child, regardless of disabilities or income, with a free and public education, which may include special education and related services for any disabilities. Relator Toni Barron is an independent speech language pathologist, and provided speech therapy services to students qualified to receive these services. Barron operated under a contract with the Judson Independent School District and the Southwest Independent School District. Relator Vicky Scheel is an independent physical therapist and provided services to students qualified to receive her services pursuant to a contract with the Judson Independent School District and the Northeast Independent School District.

Under the IDEA, when services are deemed to be medically necessary, a portion of the cost of these services may be reimbursed to the school districts by Medicaid, under a program titled, School Health and Related Services (SHARS). This suit focuses on funds derived through the SHARS program from Medicaid. Each state is permitted to establish its own state plan for eligibility standards, rates for payments, and scope of services within the SHARS program, although Medicaid is funded jointly by the federal and state governments. The Texas Education Agency and the Texas Department of Health contracted with Deloitte & Touche and Medicaid Solutions of Texas (Medicaid Solutions) to provide billing and consulting services to the SHARS providers in Texas. The Texas Department of Health contracted with National Heritage to be the administrator and fiscal agent of all Medicaid programs, including SHARS, to process and pay valid Medicaid claims to the school districts. National

Heritage would then submit claims to Medicaid for appropriate federal reimbursement.

Basically, Barron and Scheel allege in this action Deloitte & Touche and Medicaid Solutions caused the school districts to bill Medicaid for services that were not medically necessary or otherwise valid claims under the SHARS Medicaid program. Barron and Scheel allege National Heritage failed to adequately monitor submitted SHARS claims for accuracy and validity before submitting them for final payment to the United States. Barron and Scheel allege that, together, the defendants knowingly submitted false claims for Medicaid reimbursement and knowingly made or used or caused to be made or used false records or statements to get false claims paid through Medicaid reimbursement.

Barron and Scheel originally filed this action on April 8, 1998, but subsequently voluntarily dismissed the action without prejudice. Following hearings by the Senate Finance Committee on issues relevant to this lawsuit in June 1999, Barron and Scheel then filed this pending action on September 30, 1999, alleging the same facts and causes of action as the previous suit. As required in *qui tam* lawsuits, the complaint was sealed. Barron and Scheel then proceeded to request intervention by the United States of America. However, the United States twice declined to intervene. Consequently, on February 24, 2000, this District Court ordered the complaint to be unsealed and ordered Barron and Scheel to serve all defendants with summons and a copy of the complaint pursuant to the Federal Rules of Civil Procedure. Due to oversight, the District Clerk's Office did not unseal the complaint, nor did it "enter" the filed pleadings

and documents on the Court's docket; however, it did mail the February 24, 2000 order to Barron and Scheel's attorney.

On April 4, 2000, this District Court ordered the parties to file scheduling recommendations. On April 7, 2000, the District Clerk's Office unsealed the complaint and "entered" it on the docket. On April 10, 2000, the District Clerk's Office "entered" all other previously filed pleadings and documents on the Court's docket. Consequently, the Court's docket reveals the date all pleadings, documents, and orders were filed with the Court prior to April 10, 2000, but reveal the documents were "entered" on April 10, 2000. Barron and Scheel served all defendants with process on August 4, 2000, and August 7, 2000, by certified mail with return receipt requested.

As required by the Federal Rules of Civil Procedure, prior to filing an answer to the complaint, Deloitte & Touche and National Heritage moved to dismiss the complaint for many reasons, including whether the statute upon which Barron and Scheel based their complaint was unconstitutional. Prior to the time for Barron and Scheel to respond to these defendants' motions to dismiss, on June 15, 2001, this District Court granted Deloitte & Touche's unopposed motion to stay the litigation pending the Fifth Circuit's determination of a case which would decide the issue whether the statute upon which Barron and Scheel based their complaint was constitutional. The District Court denied these defendants' motions to dismiss subject to reurging after the stay was lifted.

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The stay in the litigation was lifted on March 1, 2002. Subsequently, Deloitte & Touche and National Heritage reurged these motions to dismiss, excluding the issue of constitutionality, and Barron and Scheel have responded to each. This Court will first determine Deloitte & Touche's motion to dismiss and then proceed to National Heritage's motion to dismiss.

I. DELOITTE TOUCHES MOTION TO DISMISS

Deloitte & Touche moves to dismiss Barron and Scheel's complaint with prejudice based upon the following contentions: (1) the allegations underlying the complaint have been previously and publicly disclosed, thereby triggering a statutory jurisdictional bar; (2) Barron and Scheel failed to effect timely and proper service of process; (3) the complaint fails to sufficiently plead the fraud claim.

A. Subject-Matter Jurisdiction

The False Claims Act bars certain *qui tam* actions by providing its own jurisdictional limitation, stating:

> (A) No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is the original source of the information.

> (B) For purposes of the paragraph, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on that information.

31 U.S.C. § 3730(e)(4)(A), (B). To determine subject-matter jurisdiction over a suit brought under the False Claims Act, therefore, this Court must determine whether there has been a "public disclosure" of the allegations or transactions forming the basis of the lawsuit. ***Federal Recovery Servs., Inc. v. United States***, 72 F.3d 447, 450 (5th Cir. 1996); ***United States ex rel. Richardson v. E-Systems, Inc.***, No. 3:90-CV-0607-P (N. D. Tx. 1999), at *1-2; ***see also United States ex rel. E. Hafter, D.O. v. Spectrum Emergency Care, Inc.***, 190 F. 3d 1156, 1161 (10th Cir. 1999); ***Cooper v. Blue Cross & Blue Shield of Fl., Inc.***, 19 F.3d 562, 565 n.4 (11th Cir. 1994). If so, the Court must determine whether the action is based upon such public disclosure. ***Federal Recovery Servs., Inc.***, 72 F.3d at 450. In addition, the Court must determine whether the exception to the general rule of jurisdiction applies: whether the relator is the "original source of the information."[2] ***See id.; 31 U.S.C. § 3730(e)(4)(A), (B).***

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2. The cited cases state that this Court's jurisdictional inquiry is a three-or-four part test, starting with the issue whether there was a public disclosure of the information, and if so, whether this information serves as the basis of the lawsuit, and if so, whether the relator is the "original source." However, the statute specifies the last issue of this inquiry, i.e. whether the relator is the original source,

(Cont'd)

Appendix C

Statutes which confer jurisdiction on federal courts must be strictly construed and any doubt must be resolved against federal jurisdiction. ***Boelens v. Redman Homes, Inc.***, 748 F.2d 1058, 1067 (5th Cir. 1984); ***United States ex rel. Johnson v. Shell Oil Co.***, 33 F.Supp.2d 528, 532-533 (E.D.TY. 1999). The relator in a *qui tam* action bears the burden of proof of jurisdiction, which includes alleging facts sufficient to establish jurisdiction and supporting those facts with competent proof. ***United States ex rel. Fine v. MK-Ferguson Co***., 99 F.3d 1538, 1543-1544 (10th Cir. 1996). Mere conclusory allegations of jurisdiction are insufficient. ***Penteco Corp. Ltd. Partnership v. Union Gas Sys. Inc.***, 929 F.2d 1519, 1521 (10th Cir. 1991). If relators fail to meet this burden, the Court must dismiss the suit for lack of jurisdiction pursuant to Rule 12(b)(1), Fed.R.Civ.P.

(Cont'd)

as an exception to the general rule of jurisdiction by stating "No court shall have jurisdiction . . . unless" the action is brought by the original source. Meaning, the court will have jurisdiction over an action even if there has been a public disclosure of information and this forms the basis of the lawsuit, if the relator is the original source of the information. Consequently, the issue of "original source" need not be the third, or last, prong of a sequential inquiry, but can be determined first because if this issue is answered affirmatively, the issue of public disclosure is irrelevant. Likewise, if a court determines there has been no public disclosure, or the action is not based upon a public disclosure, the issue of "original source" is irrelevant. In any event, without precedent following this reasoning, this Court will follow the traditional, sequential analysis, beginning with the issue of "public disclosure", even though the parties dispute focuses on whether Barron and Scheel are the original source of the information, and this issue could be dispositive of the entire dispute of subject matter jurisdiction.

Appendix C

Barron and Scheel's burden of proof is complicated by the disjunctive and negative wording of Section 3730 (e) (4) (A) and courts' precedential interpretation of the statute. Under the first two prongs of the precedential jurisdiction test, Barron and Scheel must show there was no public disclosure of the allegations or transactions forming the basis of the lawsuit and, even if one did occur, the action before the Court is not based upon such public disclosure. ***See Federal Recovery Servs., Inc.***, 72 F.3d at 450-451; ***United States ex ref. Richardson v. E-Systems, Inc.***, No. 3:90-CV-0607-P, at *1-2; ***see also United States ex rel. E. Hafter, D. O.***, 190 F.3d at 1161; ***Cooper v. Blue Cross & Blue Shield of Fl., Inc.***, 19 F.3d 562, 565 n.4 (11th Cir. 1994). Therefore, Barron and Scheel must prove the negative to prove jurisdiction. If Barron and Scheel satisfy this burden, this Court has jurisdiction over the *qui tam* action. However, even if they satisfy their statutory burden of proof, under the interpretative test, Barron and Scheel then have the additional burden of proof to show they are the original source of the information to avoid any possible jurisdictional bar in the event the defendants allege they are not the original source. ***See Federal Recovery Servs., Inc.***, 72 F. 3d at 450-451.

1. Public Disclosure

The "public disclosure" determination requires a two-part analysis: (1) whether the alleged disclosure originated in one of the sources enumerated in the False Claims Act; (2) whether the critical elements of the alleged fraudulent transaction were disclosed in the public domain. ***Federal Recovery Servs., Inc.***, 72 F.3d at 451; ***United States ex rel. Johnson***, 33 F.Supp.2d at 540-541. Deloitte & Touche

argues there was a public disclosure of the critical elements of the alleged fraudulent transaction in this case on June 17, 1999, when the Senate Finance Committee met to hear testimony about potentially improper submissions of Medicaid claims for school-based health services. Deloitte & Touche attach excerpts of testimony transcript to prove public disclosure forming the basis of the lawsuit, and the lawsuit is, in fact, based upon the fraudulent allegations raised in these public disclosures. ***See Deloitte & Touche's Exh. A,B,C***. However, as discussed, the jurisdiction burden of proof falls on Barron and Scheel to show there was no public disclosure.

Barron and Scheel fail to contest Deloitte & Touche's arguments regarding the first two prongs of the jurisdiction test. Instead, Barron and Scheel seemingly concede these points and skip right to the third prong: whether they are the original source of the information. To present this argument, Barron and Scheel provide a chart of the chronology of events leading up to the filing of this lawsuit. This chart seemingly admits a public disclosure took place by placing a heading on one of the columns titled "Public Disclosures: U.S. Senate Finance Committee-June 17, 1999." **See Relator's response to Deloitte & Touche's motion to dismiss, pp. 11-18, column 4**. Barron and Scheel provide no evidence to satisfy their burden of proof to show there was no public disclosure.

Consequently, this Court must conclude, based upon the evidence submitted by Deloitte & Touche, the seeming admission by Barron and Scheel, and the lack of evidence provided by Barron and Scheel, that there was a public disclosure and the information provided therein forms the

basis of this lawsuit. With this, subject matter jurisdiction is destroyed, and under the traditional, precedential test, the inquiry would stop here. ***See 31 U.S. C. § 3730(e)(4)(A)***; ***see also Federal Recovery, Inc.***, 72 F.3d at 450-451. However, Barron and Scheel argue they are the original source of the information, and under the statute, if they can prove this, subject matter jurisdiction is restored. Therefore, this Court will proceed to this argument.

2. Original Source

If the answer to the issue whether Barron and Scheel are the original source of the information forming the basis of this lawsuit is affirmative, this Court possesses subject matter jurisdiction, and the issue of public disclosure is irrelevant. ***See 31 U.S.C. § 3730(e)(4)(A), (B)***. Pursuant to the requirements of the False Claims Act, to qualify as an original source, Barron and Scheel must demonstrate: (1) they have direct and independent knowledge of the information on which the allegations are based, and (2) they voluntarily provided such information to the government prior to filing suit. ***See United States ex rel. Rafter, D. O.***, 190 F. 3d at 1161 (**quoting *United States ex rel. Precision Co. v. Koch Indus., Inc.***, 971 F. 2d 548, 553 (10th Cir. 1992)). "Direct knowledge" means first-hand knowledge of the material elements of the alleged fraud which the relator has gained through his "'own efforts and not acquired from the labors of others.'" ***United States ex rel. Johnson***, 33 F.Supp.2d at 541 (citing ***Federal Recovery Servs., Inc.***, 72 F.3d at 452). "Independent knowledge" is "'knowledge that is not itself dependent on a public disclosure'" and knowledge which is not "'derivative of the information of others. . . .'" ***United***

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States ex rel. Johnson, 33 F.Supp.2d at 542 (***quoting United States ex rel. Springfield Terminal Railway Co. v. Quinn***, 14 F.3d 645, 656 (D.C. Cir. 1994) and ***United States ex rel. Fine v. Advanced Sciences, Inc.***, 99 F.3d 1000, 1006-07 (10th Cir. 1996), respectively).

Barron and Scheel contend they can prove they are the original source of the information upon which the allegations are based because they filed their first complaint in 1998, prior to the Senate Finance Committee Hearings, which Deloitte & Touche alleges is the public disclosure divesting this Court of jurisdiction. After they filed the first lawsuit in 1998, Barron and Scheel allege they also had "numerous communications" with "Officials from the United States Government," listing the communications' dates, forms, and participants. Barron and Scheel also provide in their response a chronological table showing the timing of these communications, the complaints filed, and the Senate Hearing.[3] However, the evidence submitted by Barron and Scheel to support their response to Deloitte & Touche's motion to dismiss is insufficient to satisfy their burden of proof on the issue whether the information was gained through their own independent efforts and whether the information was voluntarily provided to the Government prior to filing this lawsuit. Barron and Scheel provide no

3. While this chronological table is helpful in presenting their argument, it is not competent evidence of the jurisdictional matters to be proven. Barron and Scheel provide nothing to verify or corroborate this information, and it appears in their argument, only, not as evidence. For this Court to consider this chronological table as true evidence, Barron and Scheel must provide verification and must substantiate the content through competent evidence.

evidence to show they gained any knowledge of the fraudulent activity through their own efforts, and therefore, have failed to satisfy the first prong of their burden of proof on the issue whether they are the original source of the information.

In support of the second prong of their jurisdictional burden of proof, i.e. whether they voluntarily provided this information to government officials, Barron and Scheel provide a telephone-bill record of "Michael Scheel," presumably relator Vicki Scheel's husband. See Relator's Exh., tab 4. This record is not verified. The record presumably contains a listing of all telephone calls made from January 25, 1999, to February 16, 1999, by this customer. On this record, beside specific calls made, are handwritten notations of names, presumably referring to the person spoken to. Barron and Scheel contend these people are various agents of the U.S. Department of Health and Human Services and these conversations regarded the subject matter of this lawsuit. These contentions are also not attested to or verified.

This archaic listing of telephone calls is insufficient to show Barron and Scheel both gained independent knowledge of the information forming the basis of this lawsuit and is insufficient to show they voluntarily surrendered any information to the proper Government officials prior to filing this lawsuit. This telephone record does not prove the content of any relative discussions with any government officials, nor does it verify that these phone numbers are those of the purported government officials. All this exhibit proves is that someone placed telephone calls from a number registered to "Michael Scheel, " to certain telephone numbers, on specific

dates prior to this lawsuit, and spoke for a certain amount of time. Barron and Scheel provide no other evidence pertaining to the issue whether they are the original source of the information forming the basis of this lawsuit, not even a personal affidavit. Barron and Scheel provide no evidence pertaining specifically to relator Toni Barron.

On this same date, this Court has granted Barron and Scheel's second motion to supplement exhibits. In this motion, Barron and Scheel provide as additional evidence to support their original source argument Deloitte & Touche's reply memorandum in support of its motion to dismiss in a similar, but different lawsuit, ***United States ex rel. Gudur v. Texas Dep't of Health***. In the Gudur lawsuit, the relator alleges Deloitte & Touche committed similar fraudulent acts related to its billing practices to Medicaid under the SHARS program. ***See Relator's second motion to supplement exhibits, p. 1.*** Barron and Scheel contend that in this reply memorandum in the ***Gudur*** suit, Deloitte & Touche admits Barron and Scheel are the original source of the information forming the basis of this lawsuit.

In this reply memorandum, Deloitte & Touche argues the relator in the ***Gudur*** suit fails to satisfy his burden of proof on the public disclosure prong because (1) there was a prior published General Accounting Report; (2) there was the prior Senate Finance Committee Meeting; and (3) this lawsuit based upon the same allegations of a fraudulent scheme was filed prior to that lawsuit. Barron and Scheel attempt to argue that these arguments by Deloitte & Touche amount to a judicial admission that Barron and Scheel are the original source of the information forming the basis of

this lawsuit. This argument fails. The reply memorandum filed by Deloitte & Touche in the ***Gudur*** lawsuit does not amount to a judicial admission in this lawsuit, nor does it serve as evidence of Barron and Scheel's burden of proof. In addition, the statements made in the reply memorandum do not admit that Barron and Scheel are the original source of the information forming the basis of this lawsuit, but argue only that a prior public disclosure of the information forming the basis of that lawsuit occurred, namely this lawsuit. ***Id. at 2,4,6-8***. Therefore, even with the submission of the supplemental exhibit, Barron and Scheel have failed to satisfy their burden of proof on the issue whether they are the original source of the information forming the basis of this lawsuit.

Because the evidence presented is insufficient to satisfy Barron and Scheel's burden of proof on this prong of the jurisdictional issue, this Court concludes Barron and Scheel have failed to show there was no public disclosure and have failed to show they are the original source of any information forming the basis of this lawsuit. Therefore, Barron and Scheel have failed to prove this Court possesses subject-matter jurisdiction over this lawsuit. For these reasons, this Court recommends Deloitte & Touche's motion to dismiss for lack of subject matter jurisdiction pursuant to Rule 12(b)(1) be ***GRANTED***.

B. Service of Process

Although this Court recommends Deloitte & Touche's motion to dismiss be granted, it will discuss the remaining issues in the alternative, should the District Court reach these issues. Deloitte & Touche contends Barron and Scheel's

complaint should be dismissed with prejudice because they failed to effect proper and timely service of process. Specifically, Deloitte & Touche contends Barron and Scheel should have served it with process on or before June 24, 2000, or within 120 days from February 24, 2000, the date the District Court ordered the complaint be unsealed and served upon all defendants. Deloitte & Touche also contends service was ,improper because it was effected through the United States' mail by Barron and Scheel's attorney. Deloitte & Touche contends this avenue of service is not available for service of process pursuant the Federal Rules of Civil Procedure and cannot be done by the relators' attorney, who is an interested party.

Barron and Scheel respond that the 120 days within which they must serve process began to run on the date the District Clerk's office "entered" the District Court's order dated February 24, 2000, on its docket, or April 10, 2000. Pursuant to this timeline, Barron and Scheel contend their service of process as to the Deloitte & Touche group members on August 4, 2000, and August 7, 2000, was timely. Further, Barron and Scheel contend the Federal Rules of Civil Procedure allow for service of process via the United States' mail by their attorney.

1. Timeliness of Service of Process

Federal Rule of Civil Procedure 4(m) requires a plaintiff to serve all defendants with a copy of the complaint and the summons within 120 days after the filing of the complaint. **FED. R. CIV. P. 4(m)**. The purpose of Rule 4 (m) is to ensure the defendants will be promptly notified of any impending

lawsuit to prevent any possible prejudice resulting from delay, such as, loss of evidence, dimming of witness' memory, financial commitments based upon not being sued, etc., and to give the Court jurisdiction over the defendants. ***See Electrical Specialty Co. v. Road & Ranch Supply, Inc.***, 967 F.2d 309, (9th Cir. 1992); ***Bennet v. Circus U.S.A.***, 108 F.R.D. 142, 148 (N.D. Ind. 1985). If service is not made within 120 days of the filing of the complaint, the court "shall dismiss the action without prejudice as to that defendant or direct that service be effected within a specified time" unless the plaintiff can demonstrate good cause for the failure to complete service within the required time. ***Id.*** Plaintiffs bear the burden of proof in demonstrating good cause for any failure to comply with the 120-day time limit. ***See Systems Signs Supplies v. United States Dep't of Justice***, 903 F.2s 1011, 1013 (5th Cir. 1990). Any dismissal pursuant to Rule 4(m) is without prejudice. ***See Norfolk v. City of Garland***, 768 F.2d 654, 658 (5th Cir. 1988) .

While dismissal was mandatory prior to the 1993 amendments to Rule 4(m), courts subsequently have been given broad discretion in deciding whether to dismiss a case for failure to effect service within the 120-day time limit absent a showing of good cause. ***See Committee Notes to 1993 Amendments to FRCP 4(m)***; ***See also Petrucelli v. Bohringer & Ratzinger GmBH Ausdereitungsanlagen***, 46 F.3d 1298, 1305 (3d Cir. 1995); ***Espinoza v. United States***, 52 F.3d 838, 840 (10th Cir. 1995). In a determination whether to exercise its discretion to dismiss a case for failure to timely serve the defendants, a court may consider such factors as: (1) whether the applicable statute of limitations would bar refiling if the action were dismissed; (2) whether the delay

will prejudice defendant's ability to defend on the merits; (3) whether the defendant is evading service; (4) whether the defendant had concealed a defect in attempted service; or (5) whether service was eventually accomplished, and if so, how long after the 120-day period. ***See Committee Notes to 1993 Amendments to FRCP 4(m)***; ***See also Petrucelli***, 46 F.3d at 1305; ***Goodstein v. Bombardier Capital, Inc.***, 167 F.R.D. 662, 666 (D. Vt. 1996).

In this case, this Court concludes Barron and Scheel have failed to show good cause for their failure to serve the defendants within 120 days of the District Court's order dated February 24, 2000. Although the Court's order was not entered onto the docket until April 10, 2000, this mishap did not have any bearing on the Court's order for Barron and Scheel to serve the defendants with the complaint. Barron and Scheel were aware of this order in sufficient time to timely serve the defendants, or they should have been alerted on April 4, 2000, when the District Court entered its Scheduling Recommendations order. (See Docket No. 9). Consequently, the defendants should have been served with process by June 24, 2000. Barron and Scheel offer no reason other than the delay of entry on the docket for their failure to timely serve Deloitte & Touche. This reason does not establish "good cause."

However, this Court also concludes that based upon the procedural anomalies in this case and after a weighing of the applicable considerations, this Court should exercise its discretion in this matter and decline to dismiss Barron and Scheel's complaint based upon untimely service. First, any dismissal at this stage of the litigation would prevent Barron

and Scheel from refiling because the statute of limitation has expired. Second, Deloitte & Touche received sufficient notice of the impending suit. Finally, the case was stayed pursuant to a motion filed by Deloitte & Touche and unopposed by National Heritage.

Consequently, this action was stayed for approximately one year and 3 months at the behest of Deloitte & Touche and National Heritage, not Barron and Scheel, and as a result, the statute of limitations ran while the parties awaited determination by the Fifth Circuit of a collateral issue. Because the case was stayed on motion by Deloitte & Touche and National Heritage, these parties cannot now argue prejudice by any defect in service of process in the presentation of their defenses. Although this Court does not desire to minimize the importance of timely service of process or ignore the fact that Barron and Scheel failed to adhere to this rule, the Court finds the purpose of Rule 4(m) has been met in this case, despite the untimely service. Consequently, should the District Court reach this issue, the Court recommends Deloitte & Touche's motion to dismiss on the basis of untimely service of process be **DENIED**.

2. Improper Service

Service of process may be effected "by any person who is not a party and who is at least 18 years of age." **Federal Rule Civil Procedure** 4(c)(2). Under the federal rules, a party's attorney qualifies as "any person" and thus can serve process. ***See Jugolinija v. Blue Heaven Mills, Inc.***, 115 F.R.D. 13, 15 (S.D. Ga. 1986). Federal Rule of Civil Procedure 4(e)(1) authorizes a plaintiff to serve process on

an individual defendant according to any of the methods set out therein. **See FEDERAL RULE CIVIL PROCEDURE 4(e)(1).** One of the methods authorized by Rule 4(e)(1) is any service allowed pursuant to the law of the state where the district court is located or where service is effected. **Id.** Further, Rule 4(h) prescribes the proper manner of service of process upon business defendants. Pursuant to Rule 4(h)(1), a plaintiff may effect service upon a business defendant:

> in the manner prescribed for individuals by subdivision (e) (1) , or by delivering a copy of the summons and of the complaint to an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process and, if the agent is one authorized by statute to receive service and the statute so requires, by also mailing a copy to the defendant.

FEDERAL RULE CIVIL PROCEDURE 4(h)(1).

Should a party choose to effect service of process by Texas law under Rule 4(e)(1), pursuant to Texas state law, service of process may be effected by any person authorized by law who is not less than 18 years of age. **TEXAS RULE OF CIVIL PROCEDURE 103.** No person who is a party or who is interested in the outcome of the case may serve any process. ***Id.*** Service of process may be effected by any person authorized by Rule 103 by mailing to the defendant by registered or certified mail, return receipt requested, a true copy of the citation with a copy of the petition attached. **TEXAS RULE OF CIVIL PROCEDURE 106(a)(2).**

Appendix C

Barron and Scheel contend service of process was proper under a combination of the Federal and Texas Rules of Civil Procedure. They contend they elected to defer to Texas law pursuant to Federal Rule 4(e)(1) and 4(h)(1), and under Texas Rule 106(a)(2), service by certified mail, with return receipt requested, is valid. Further, Barron and Scheel contend Federal Rule 4(c)(2) provides service of process may be effected by a party's attorney.

This Court holds Barron and Scheel cannot sort through the Federal and Texas Rules of Civil Procedure and pick and choose those portions most favorable. Barron and Scheel are correct in asserting Federal Rule 4(e)(1) and 4(h)(1) provides them the opportunity to serve Deloitte & Touche pursuant to Texas law, and Texas Rule 106(a)(2) provides service of process on a business defendant may be effected by mailing it registered or certified mail with a return receipt requested. However, Texas Rule 106 also explicitly states service of process must be effected by someone authorized by Texas Rule 103, and Texas Rule 103 eliminates any person interested in the outcome of the lawsuit. In Texas, a party's attorney is one who is interested in the outcome of the lawsuit under Texas Rule 103, and therefore, eliminated from those available to effect service of process. ***See Jackson v. United States***, 138 F.R.D. 83, 87 (S.D. Tx. 1991); ***HB & WM, Inc. v. Smith***, 802 S.W.2d 279, 281-82 (Tex. App. - San Antonio, 1990, no writ). Although a party's attorney may be given leeway to effect service of process under Federal Rule 4(c)(2), this rule pertains only when those avenues available under the federal rules are chosen, and does not trump the established state law, should a party choose to defer to state law. Consequently, Barron and Scheel's argument that service

of process was proper under a combination of the Federal and Texas Rules is without merit, and must fail.

Barron and Scheel also assert that service of process by mail is proper under Federal Rule 4(h)(1), pursuant to the last phrase, "by also mailing a copy to the defendant." However, Barron and Scheel take this phrase out of context and misconstrue its meaning. Federal Rule 4(h)(1) denotes that if service is made on an agent authorized by statute to accept service, the plaintiff must also mail an additional copy of the summons and complaint to the business defendant, if also required by statute. ***See*** **FEDERAL RULE OF CIVIL PROCEDURE 4(h)(1)**; ***see also Moore's Federal Practice 3d ed. § 5 4.54[1], p. 4-71.*** Consequently, Barron and Scheel cannot rely on this portion of Federal Rule 4(h) to effect service of process by mail under the Federal Rules of Civil Procedure.

However, although service of process was improper, and insufficient service of process destroys this Court's jurisdiction, this Court is not required to grant a motion to dismiss for insufficient service of process, but may elect to quash service and provide ample time for the plaintiff to re-serve the defendant. ***See*** **FEDERAL RULE OF CIVIL PROCEDURE** 4(m); ***see also Adams v. AlliedSigaal Gen. Aviation Avionics***, 74 F.3d 882, 886 (8th Cir 1996). Given the procedural posture of this case and the effective statute of limitations bar should this Court dismiss this case at this stage, this Court concludes granting Deloitte & Touche's motion to dismiss would be inequitable. Consequently, this Court recommends that service of process be quashed and

Barron and Scheel be provided ample time to re-serve Deloitte & Touche, unless Deloitte & Touche agrees to waive such requirement.

3. Waiver of Service of Process

Finally, Barron and Scheel contend Deloitte & Touche waived any objection to service of process by entering a general appearance, and thereby, submitted itself to this Court's jurisdiction. Barron and Scheel contend Deloitte & Touche did this by filing its motion to dismiss raising the insufficient service, by moving to stay the proceeding, by filing an agreed motion to extend the time for Barron and Scheel to respond to its motion to dismiss, by filing an agreed motion to lift the stay, and a motion to re-urge its motion to dismiss, all without specifying these pleadings were subject to a "special appearance."

This Court concludes Barron and Scheel's argument is without merit. Under Federal Rule of Civil Procedure 12 (b) there is no longer any necessity for appearing specially to protest the court's jurisdiction or question the sufficiency of process or service of process. ***See Housing Auth. of the City of Atlanta v. Millwood***, 472 F.2d 268, 272 (5th Cir. 1973). Rule 12 (b) requires only that all such objections be asserted in an answer or motion to dismiss, the procedure followed below by Deloitte & Touche. ***Id.*** Consequently, Deloitte & Touche has not waived any objection to insufficient service of process.

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C. Pleading with Particularity

Deloitte & Touche contend Barron and Scheel's suit should be dismissed with prejudice because they fail to plead the fraud allegations and the facts supporting such allegations with particularity, as required by Federal Rule of Civil Procedure 9(b). Deloitte & Touche bases its arguments related to this issue on Barron and Scheel's original complaint. However on this same date, this Court has granted Barron and Scheel's motion for leave to amend the complaint. Consequently, the parties' discussion of this issue is now moot or inapplicable to the current complaint. Therefore, this Court will not discuss this issue.

II. NATIONAL HERITAGE'S MOTION TO DISMISS

National Heritage moves to dismiss Barron and Scheel's complaint with prejudice based upon the following contentions: (1) the allegations underlying the complaint have been previously and publicly disclosed, thereby triggering a jurisdictional bar; (2) sovereign immunity; (3) the complaint fails to sufficiently plead the fraud claim pursuant to Federal Rule of Civil Procedure 9(b); (4) Barron and Scheel failed to effect timely and proper service of process; and (5) Barron and Scheel fail to state a claim upon which relief can be granted.

A. Subject Matter Jurisdiction

To limit the volume of paper submitted to this Court, National Heritage moves pursuant to Federal Rule of Civil Procedure 10(c), to incorporate and adopt the entirety of

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Deloitte & Touche's argument related to this Court's subject-matter jurisdiction specified in the False Claims Act. This motion will be **GRANTED**. Barron and Scheel also incorporate their entire response in relation to this argument from their response to Deloitte & Touche's motion to dismiss. However, Barron and Scheel submit additional evidence in support of their response as support for this argument. Consequently, this Court will incorporate Barron and Scheel's arguments from their response to Deloitte & Touche's motion to dismiss, but will consider only the evidence submitted in this response to National Heritage's motion to dismiss as support for these arguments.

1. Public Disclosure

As before, and for the same reasons, this Court concludes Barron and Scheel have failed to satisfy their burden of proof regarding jurisdiction by failing to show that a public disclosure forming the basis of this lawsuit did not occur. Barron and Scheel provide no evidence to satisfy their burden of proof to show there was no public disclosure. Consequently, this Court must conclude, based upon the evidence submitted by National Heritage, the seeming admission by Barron and Scheel, and the lack of evidence provided by Barron and Scheel, that there was a public disclosure and the information provided therein forms the basis of this lawsuit.

However, under the exception to this general rule, if Barron and Scheel can show they are the original source of this information, this Court's jurisdiction will be restored. This Court again concludes that Barron and Scheel have

failed to satisfy this requirement. However, because Barron and Scheel have submitted additional evidence pertaining to this prong of their burden of proof, this Court will address this prong, specifically.

2. Original Source

If the answer to the issue whether Barron and Scheel are the original source of the information forming the basis of this lawsuit is affirmative, this Court possesses subject matter jurisdiction, and the issue of public disclosure is irrelevant. ***See* 31 U.S.C. § 3730(e)(4)(A), (B)** . As previously noted, to qualify as an original source, Barron and Scheel must demonstrate: (1) they have direct and independent knowledge of the information on which the allegations are based, and (2) they voluntarily provided such information to the government prior to filing suit. ***See United States ex rel. E. Hafter, D.O.***, 190 F.3d at 1161 (***quoting United States ex rel. Precision Co.***, 971 F.2d at 553).

While Barron and Scheel make these allegations in their complaint and in their response, Barron and Scheel provide no competent evidence to show they gained any knowledge of the fraudulent activity through their own efforts, and therefore, have failed to satisfy the first prong of their burden of proof on the issue whether they are the original source of the information.

As support for their contention they voluntarily provided information to government officials prior to filing suit, Barron and Scheel submit the same telephone records by reference to the evidence submitted in response to the Deloitte

& Touche motion and, additionally, an affidavit by Vickie Scheel. In the affidavit, Scheel attests to the veracity of the telephone records, attests the records are, in fact, her personal records of her telephone, and attests the telephone calls were placed to various government officials to notify them of the allegations forming the basis of the lawsuit. ***See Relator' s Exh. 5***. In her affidavit, Scheel also attests the information provided in Barron and Scheel's table within their response is true "to the best of my knowledge."

Even with the affidavit by Scheel, the Court concludes Barron and Scheel have failed to satisfy their burden of proof on this prong. Barron and Scheel still fail to provide any evidence relative to Toni Barron. Even with Scheel's affidavit, all the evidence shows is Scheel made telephone calls to various numbers from January 25, 1999, to February 16, 1999. She does not testify which governmental officials or agencies were called, nor does she provide any specific information regarding the content of any of these discussions. Barron and Scheel provide no other evidence pertaining to the issue whether they are the original source of the information forming the basis of this lawsuit. Because the evidence presented is insufficient to satisfy Barron and Scheel's burden of proof on this prong of the jurisdictional issue, this Court concludes Barron and Scheel have failed to prove this Court holds subject matter jurisdiction over this lawsuit.

Even with Scheel's affidavit, Barron and Scheel have failed to satisfy their burden of proof to show this Court holds subject matter jurisdiction. First, Barron and Scheel admit there was a public disclosure and provide no evidence which

would show there was no public disclosure. Next, Barron and Scheel have failed to satisfy their burden of proof on the exception to the general rule of jurisdiction be failing to provide sufficient evidence which would prove they are the original source of the information forming the basis of this lawsuit. Barron and Scheel have not provided any evidence they attained the information independently through their own personal efforts. Based upon this, the Court could end its inquiry and find there is no subject matter jurisdiction. However, Barron and Scheel have also failed to satisfy the second prong of the original source inquiry by failing to provide sufficient and competent evidence they voluntarily surrendered any of this information to the proper Government officials prior to filing this lawsuit. For these reasons, this Court recommends National Heritage's motion to dismiss for lack of subject matter jurisdiction pursuant to Rule 12(b)(1) be **GRANTED.**

B. Sovereign Immunity

National Heritage contends it is immune from suit, because it is an "arm of the State of Texas," and therefore, entitled to sovereign immunity under the Eleventh Amendment. National Heritage argues it is an agent of the State of Texas, acting under statutory authority to administer the Medicaid-reimbursement programs. Because it acted solely under the control and supervision of the State of Texas in carrying out these responsibilities entrusted to it by statute, National Heritage contends it is entitled to sovereign immunity as an "arm of the state".

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Barron and Scheel contend National Heritage is not an "arm of the state," but is an independent, for-profit company which is contracted to ensure correct payment of submitted claims under the Medicaid-reimbursement programs such as SHARS. Barron and Scheel include National Heritage in this lawsuit alleging National Heritage failed to accurately fulfill its duties with the State of Texas, thereby allowing payment of nonrefundable claims.

The Eleventh Amendment provides "[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." **U.S. CONST., AMEND. XI**. In addition, Eleventh Amendment immunity extends to suits brought against a state by its own citizens. ***Pennhurst State Sch. & Hosp. v. Halderman***, 465 U.S. 89, 100 (1984). The Eleventh Amendment operates as an absolute jurisdictional bar to suits against a state in federal court, unless the state consents. The State of Texas does not consent to be sued in federal court.

Eleventh Amendment immunity also applies to actions in federal court against state agencies and other private agents of a state who are authorized to carry out State responsibilities "when the action is, in essence one for the recovery of money from the state. . . ." ***See Ford Motor Co. v. Dept of Treasury***, 323 U.S. 459, 464 (1945): ***Karpovs v. State of Mississippi***, 663 F.2d 640, 642 (5th Cir. 1981). Therefore, private entities that serve a public function may be entitled to sovereign immunity. ***United States v. Mack***, 48 F.Supp.2d 708, 713 (S.D. Tx. 1999): ***Citrano v. Allen Correctional Ctr.***, 891

F.Supp 312, 320-321 (W.D. La. 1995). Particularly, "fiscal intermediaries" for a state or state agency, which simply administer a state responsibility, are entitled to sovereign immunity as the state, itself, when such intermediaries act within their official capacity. ***Matranga v. Traveler's Ins. Co.***, 563 F.2d 677, 678 (5th Cir. 1977).

The question, then, that this Court must first determine is whether National Heritage is so related to the State of Texas that the suit against it is actually a suit against the State of Texas, and therefore, barred by the Eleventh Amendment. ***Mt. Healthy City Bd. of Educ. v. Doyle***, 429 U.S. 274, 280 (1976). In Eleventh Amendment cases, the question whether the state is "the real party in interest" is one of federal law, but federal courts must examine the powers, characteristics, and relationships created by state law to determine whether the suit is actually against the state itself. ***Regents of the Univ. of Cal. v. Doe***, 519 U.S. 425, 429-30 (1997). "The answer depends, at least in part, upon the nature of the entity created by state law." ***Mt. Healthy City Bd. of Educ.***, 429 U.S. at 280. Courts must examine the following six factors in this determination: (1) whether the statutes and case law characterize the agency as an arm of the state; (2) the source of the funds for the entity; (3) the degree of local autonomy the entity enjoys; (4) whether the entity is concerned primarily with local, as opposed to state-wide problems; (5) whether the entity has authority to sue and be sued in its own name; and (6) whether the entity has the right to hold and use property. ***Hudson v. City of New Orleans***, 174 F.3d 677, 681 (5th Cir. 1999). Most importantly, the Court should look at the degree of local autonomy and control, and whether the funds to defray any award would be derived from the state

treasury. ***Laje v. R.F. Thomason General Hospital***, 665 F.2d 724, 727 (5th Cir. 1982). Therefore, a state agent is not immune from suit if it operates independently from the state. Taking the allegations in the amended complaint as true, and examining the record evidence submitted by both Barron and Scheel and National Heritage, this Court concludes the above factors weigh heavily in favor of finding National Heritage to be an arm of the State, and therefore, entitled to sovereign immunity.

First, Texas law allows the responsibility of administering the SHARS Medicaid program to be delegated to a fiscal intermediary. **See Tx. Hum. Res. Cope Ann.** § 32.209(b). The contract language and Barron and Scheel's amended complaint characterize National Heritage's role as a fiscal intermediary, which receives, processes, and pays appropriate Medicaid claims submitted under the SHARS program. Such fiscal intermediaries are "arms of the State" and are, thereby, entitled to sovereign immunity. ***See e.g. Matranga***, 563 F.2d at 678; ***Peterson v. Blue Cross/Blue Shield of Tx.***, 508 F.2d 55, 58 (5th Cir. 1975); ***United States v. Mack***, 48 F.Supp.2d at 713. Even though Barron and Scheel contend National Heritage acted negligently, thereby failing to fulfill its obligation under this contract, as long as it operated within the scope of its authority under the contract, it is still entitled to sovereign immunity. ***Matranga***, 563 F.2d at 678; ***Peterson***, 508 F.2d at 58; ***United States v. Mack***, 48 F. Supp.2d at 713. There is no evidence or allegation National Heritage exceeded the scope of its authority. Therefore, the statute under which National Heritage derives its authority to act on the part of the State of Texas and the contract

language all weigh in favor of finding National Heritage to be an arm of the state for the purpose of this lawsuit under the first prong of the Hudson test.

Also under the first prong of the ***Hudson*** test, District Courts within the Fifth Circuit, including this District Court, have uniformly found National Heritage to be an arm of the state under similar facts and circumstances. ***See e.g., United States ex rel. Churchill v. The State of Texas***, No. A 00-CA-527-SS at *3-7 (W.D. Tx. 2000); ***United States v. Mack***, 48 F.Supp.2d at 713; ***Texas Hosp. Ass'n v. National Heritage Ins.***, 802 F. Supp 1507, 1512 (W. D. Tx. 1992);***St. Joseph Hosp. v. Electronic Data Sys. Corp.***, 573 F.Supp. 443, 450 (S.D. Tx. 1983) (all holding in *qui tam* actions, National Heritage is an arm of the state, and therefore, immune from suit in federal court under the Eleventh Amendment). In particular, in Churchill, National Heritage was contracted by the State of Texas to perform similar duties in the payment of Medicaid claims. Specifically, in ***Churchill***, National Heritage was alleged to have failed to pursue third-party claims prior to submitting a claim for reimbursement for federal Medicaid. The ***Churchill*** Court first placed heavy weight on the fact that many District Courts in Texas have consistently found National Heritage to be an arm of the state in similar factual situations. ***See United States ex rel. Churchill v. The State of Texas***, No. A 00-CA-527-SS, at *4. This Court also places heavy weight on this factor.

In particular, the ***Churchill*** case is a *qui tam* action filed under the False Claims Act with similar facts and allegations as the present suit. After analyzing the remaining ***Hudson*** factors, the Court concluded National Heritage was an arm

of the State. ***Id.*** In ***Mack***, National Heritage operated under a similar contract to administer the Texas Medicaid program, and under this contract, operated as a fiscal intermediary to receive, process, and pay doctors' reimbursable Medicaid claims. ***United States v. Mack***, 98 F.Supp.2d at 712-713. The ***Mack*** Court also concluded National Heritage was an arm of the State after analyzing the pertinent Hudson factors. **Id.** at 713. Therefore, given the contract language, the amended complaint, and persuasive authority from this District, the first factor weighs heavily in favor of a finding of sovereign immunity.

The Court finds the second ***Hudson*** factor also weighs in favor of finding National Heritage to be an arm of the state for the purpose of this lawsuit. The evidence and arguments do not paint a clear picture of the source of the funds to pay any damages assessed against National Heritage. However, cases have held that even though National Heritage is a privately owned company with its own resources to pay a damage award, in cases such as this, National Heritage would use funds derived from the state in its payments for services administered under the contract, and this is enough to hold a judgment against National Heritage would affect the state treasury. ***See United Carolina Bank v. Board of Regents of Stephen F. Austin Univ.***, 665 F.2d 553, 560 (5th Cir. 1982); ***Jagnandan v. Giles***, 538 F. 2d 1166, 1176 (5th Cir. 1976); ***Markowitz v. United States***, 650 F.2d 205, 206 (9th Cir. 1981).

Although it seems far reaching, in this case, National Heritage generates a portion of its income from its contract with the State of Texas. Thus, an award of damages against

National Heritage would be paid out of funds it essentially received from the State of Texas, as National Heritage would not be in a position to be sued if it was not paid by the State of Texas to administer the state's Medicaid program. On this basis, it has been held that a judgment against National Heritage would affect the state treasury. ***See United States ex rel. Churchill v. The State of Texas***, No. A 00-CA-527-SS, at *9-5 (***citing Mack***, 98 F.Supp.2d at 713). Consequently, this factor also weighs in favor of finding National Heritage entitled to sovereign immunity.

The third factor, the degree of autonomy, also weighs in favor of finding sovereign immunity following the reasoning of the ***Churchill*** decision. In ***Churchill***, the Court concluded National Heritage was controlled by the State of Texas by virtue of the contract between the two. ***See United States ex rel. Churchill v. The State of Texas***, No. A 00-CA-527-SS, at *5. National Heritage agreed to administer a responsibility of the State of Texas under its direction. ***Id***. As a contractor, the Court found National Heritage was obligated to follow the policies and procedures set by the State of Texas. ***Id.*** National Heritage did not have the autonomy or authority to deviate from these directives. ***Id.*** This Court finds the same situation in this case. National Heritage is a contractor of the State of Texas, hired to administer the Medicaid funds for appropriate claims. ***See*** **National Heritage's Exh., Tab c; see also Relator's Exh, 1.** The policies and procedures under which National Heritage performs this function are established by the State of Texas. ***See*** **National Heritage's Exh., Tab c, par. 5.** Therefore, the State of Texas exercises control over National Heritage in the distribution of these Medicaid funds, and National Heritage does not exercise any

autonomy or discretion of its own in this realm. Consequently, this Court concludes the third factor weighs in favor of finding National Heritage is entitled to sovereign immunity.

Under the fourth factor, the relevant inquiry is whether the entity acts for the benefit and welfare of the state as a whole or for the special advantage of local inhabitants. ***See Pendergrass v. Greater New Orleans Expressway Comm'n***, 144 F.3d 342, 347 (5th Cir. 1998) (***citing Jacintoport Corp. v. Greater Baton Rouge Port Comm'n***, 762 F.2d 435, 439 (5th Cir. 1985) (noting that a state's guarantee of bonds issued by an entity can be evidence, however slight, of state agency status)). In this case, National Heritage operates under its contract with the Texas Department of Health as the payment agent for all Medicaid claims in the State of Texas. Therefore, it operates for the benefit of the state as a whole, not individual, local entities. For this reason, this Court concludes the fourth factor weighs in favor of finding National Heritage is entitled to sovereign immunity.[4]

The parties do not significantly address the fifth and sixth ***Hudson*** factors: whether National Heritage can sue and be sued in its own name and whether National Heritage can hold and use property. The Court concludes that as a private entity, National Heritage has the ability to do these things, and therefore, these factors weigh against a finding of sovereign immunity. However, these factors do not weigh as heavily as those discussed previously. Based upon an analysis of the

4. Barron and Scheel contend this factor is irrelevant when an entity seeking sovereign immunity is a private entity. Therefore, it is presumed Barron and Scheel would not dispute the Court's finding relative to this factor.

relevant factors determinative of sovereign immunity, this Court concludes National Heritage acts as an arm of the State of Texas for the purpose of this lawsuit, and therefore, is entitled to Eleventh Amendment sovereign immunity from suit in federal court. On this additional basis, National Heritage's motion to dismiss should be **GRANTED**.

C. Pleading with Particularity

Like Deloitte & Touche, National Heritage contends Barron and Scheel's suit should be dismissed with prejudice because they fail to plead the fraud allegations and the facts supporting such allegations with particularity, as required by Federal Rule of Civil Procedure 9(b). As before, this Court will not address this issue because Barron and Scheel's motion for leave to amend the complaint was granted on this same date, nullifying these arguments.

D. Service of Process

National Heritage argues, as Deloitte & Touche, Barron and Scheel's complaint should be dismissed with prejudice because they failed to effect proper and timely service of process. Specifically, National Heritage contends Barron and Scheel should have served them with process within 120 days from February 24, 2000, the date this District Court ordered the complaint be unsealed and served upon all defendants. Like Deloitte & Touche, National Heritage also contends service was improper because it was effected through the United States' mail by Barron and Scheel's attorney. In response to National Heritage's arguments, Barron and Scheel incorporate their response to Deloitte & Touche's same contentions.

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1. Timeliness of Service of Process

The facts and timeline relative to Barron and Scheel's service of process on National Heritage are the same as those relative to Deloitte & Touche; however, service was executed on August 4, 2000, only. Barron and Scheel have failed to show good cause for their failure to serve National Heritage within 120 days of the District Court's order dated February 24, 2000. However, for the same reasons cited previously, this Court should exercise its discretion in this matter and decline to dismiss Barron and Scheel's complaint. Consequently, the Court recommends National Heritage's motion to dismiss on this basis be **DENIED**.

2. Improper Service

The parties present the same arguments analyzed previously regarding the issue whether service of process was proper because Barron and Scheel served National Heritage by certified mail, return receipt requested, and such process was mailed by Barron and Scheel's attorney. For the same reasons cited previously, this Court reaches the same conclusion as to National Heritage: Barron and Scheel used an improper method to serve process on National Heritage. However, although service of process was improper, and insufficient service of process destroys this Court's jurisdiction, this Court is not required to grant a motion to dismiss for insufficient service of process, but may elect to quash service and provide ample time for the plaintiff to re-serve the defendant. Given the procedural posture of this case and the effective statute of limitations bar should this Court dismiss this case at this stage, this Court concludes

granting National Heritage's motion to dismiss would be inequitable. Consequently, should the District Court reach this issue, this Court recommends service of process be quashed and Barron and Scheel allowed ample time to re-serve National Heritage, unless National Heritage agrees to waive such requirement.

E. Failure to State a Claim

National Heritage contends Barron and Scheel's complaint should be dismissed for failure to state a claim upon which relief can be granted, pursuant to Federal Rule of Civil Procedure 12(b)(6). Specifically, National Heritage contends Barron and Scheel fail to specifically describe any statement made by any representative of National Heritage and fail to allege any fact establishing a single element of an claim under the False Claims Act as to National Heritage. Essentially, National Heritage attempts to assert the same arguments it asserted previously in its contention Barron and Scheel failed to satisfy Rule 9(b). Given the fact that this Court has granted Barron and Scheel's motion to amend the complaint on this same date, this argument is now moot or nullified, as it is based upon the previous complaint. Therefore, this Court will not address this issue.

RECOMMENDATION

It is the recommendation of the Magistrate Judge that Deloitte & Touche's motion to dismiss be **GRANTED** based on lack of subject-matter jurisdiction, and National Heritage's motion to dismiss be **GRANTED** based on lack of subject-matter jurisdiction and sovereign immunity. It is

further recommended that the complaint be **DISMISSED** as to Medicaid Solutions for lack of subject matter jurisdiction.

Instructions for Service and Notice of Right to Appeal/Object

The United States District Clerk shall serve a copy of this Memorandum and Recommendation on all parties either (1) by certified mail, return receipt requested, or (2) by facsimile if authorization to do so is on file with the Clerk. Pursuant to Title 28 U.S.C. Section 636(b)(1) and Rule 72(b), Fed.R.Civ.P., any party who desires to object to this report must serve and file written objections to the Memorandum and Recommendation within 10 days after being served with a copy unless this time period is modified by the district court. A party filing objections must specifically identify those findings, conclusions or recommendations to which objections are being made and the basis for such objections; the district court need not consider frivolous, conclusive or general objections. ***Such party shall file the objections with the clerk of the court, and serve the objections on all other parties and the magistrate judge.*** A party's failure to file written objections to the proposed findings, conclusions and recommendations contained in this report shall bar the party from a de novo determination by the district court. ***See Thomas v. Arn***, 474 U.S. 140, 150 (1985). Additionally, any failure to file written objections to the proposed findings, conclusions and recommendation contained in this Memorandum and Recommendation within 10 days after being served with a copy shall bar the aggrieved party, except upon grounds of plain error, from attacking on appeal the

unobjected-to proposed factual findings and legal conclusions accepted by the district court. ***Douglass v. United Servs. Auto. Ass'n***, 79 F.3d 1415, 1428 (5th Cir. 1996).

SIGNED this 6th day of September 2002.

s/ John W. Primomo
JOHN W. PRIMOMO
United States Magistrate Judge

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT DENYING PETITION FOR REHEARING FILED DECEMBER 9, 2004

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 03-50507

United States of America, ex rel, TONI R BARRON; VICKY J SCHEEL

Plaintiffs - Appellants

v.

DELOITTE & TOUCHE, L L P; DELOITTE & TOUCHE CONSULTING GROUP, L L C; DELOITTE & TOUCHE CONSULTING GROUP HOLDING, L.L.C.; MEDICAID CLAIM SOLUTIONS OF TEXAS, INC; NATIONAL HERITAGE INSURANCE CO

Defendants - Appellees

Appeal from the United States District Court for the Western District of Texas, San Antonio

ON PETITION FOR REHEARING EN BANC

(Opinion 8/11/04, 5 Cir., ____, ____ F.3d ____)

Before KING, Chief Judge, REAVLEY and EMILIO M. GARZA, Circuit Judges.

Appendix D

PER CURIAM:

Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED as to the Court's published opinion. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing En Banc is DENIED as to the Court's published opinion.

* * *

ENTERED FOR THE COURT:

Thomas M. Reavley
United States Circuit Judge

(2)

Supreme Court, U.S.
FILED
MAY 11 2005
OFFICE OF THE CLERK

No. 04-1218

IN THE
Supreme Court of the United States

NATIONAL HERITAGE INSURANCE COMPANY,
Petitioner,

v.

UNITED STATES ex rel. TONI R. BARRON
and VICKY SCHEEL,
Respondents.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

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May 2005

QUESTION PRESENTED

Whether the Fifth Circuit erred in applying its standard multi-factor test for determining whether an entity is an arm of the state for Eleventh Amendment purposes – a test that emphasizes the state's legal liability for a judgment against an entity, in this case a private, for-profit corporation that contracted with the State of Texas to serve as a Medicaid claims administrator.

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INTRODUCTION

In determining whether an entity is an "arm of the state" for Eleventh Amendment immunity purposes, this Court considers multiple "indicators of immunity or the absence thereof," *Hess v. Port Authority Trans-Hudson Corp.*, 513 U.S. 30, 44 (1994) – including how state law defines the entity and the degree of control the state exerts over the entity – and gives particular weight to whether the state would be liable for a judgment against the entity. *Id.* at 44-48. The courts of appeals, including the Fifth Circuit in the decision below, follow this Court's guidance and use multi-factor tests that pay particular attention to the state liability factor.

In its petition for a writ of certiorari, Petitioner seizes on out-of-context language and on inconsequential differences in how the circuits describe their multi-factor tests to support its assertion that multiple circuit conflicts exist over when an entity should be deemed an arm of the state. In an attempt to depict a conflict, Petitioner principally relies on *Shands Teaching Hospital and Clinics, Inc. v. Beech Street Corp.*, 208 F.3d 1308 (11th Cir. 2000). However, the Fifth Circuit specifically distinguished *Shands* in its decision below. Furthermore, contrary to Petitioner's assertions, although the courts of appeals have rarely needed to consider whether a private, for-profit entity should enjoy the constitutional immunity generally reserved for the states, the circuits that have considered the issue have applied their standard multi-factor tests to private, as well as public, entities. In short, the approaches used by this Court and the courts of appeals for determining whether an entity is an arm of the state are remarkably consistent. Accordingly, the petition for a writ of certiorari should be denied.

STATEMENT OF THE CASE

Toni Barron, a speech language pathologist, and Vicky Scheel, a physical therapist (collectively, "the relators"), provided therapeutic services to students in Texas school districts. After witnessing fraudulent Medicaid billing for student health related services, they filed a qui tam action under the False Claims Act, 31 U.S.C. § 3729, alleging that National Heritage Insurance Company (NHIC), Deloitte & Touche, and Medicaid Claim Solutions of Texas knowingly submitted or caused to be submitted false claims to the United States for Medicaid reimbursement funds. In particular, they alleged that Deloitte & Touche and Medicaid Claim Solutions instructed local school districts to engage in improper Medicaid billing practices, and that NHIC, which processed claims and distributed Medicaid funds, acquiesced in those billing practices by failing properly to monitor claims and payments.

NHIC moved to dismiss the case, arguing that it was immune from suit under the six-factor test used by the Fifth Circuit to determine whether an entity is an arm of the state for Eleventh Amendment purposes. The district court agreed and granted the motion.

In their briefs on appeal to the Fifth Circuit, both NHIC and the relators analyzed the facts of the case under the Fifth Circuit's six-factor test. NHIC never argued that the Fifth Circuit should apply a different test because NHIC is a private entity.

The Fifth Circuit reversed, applying the six-factor test set forth in NHIC's and the relators' briefs. Under that test, the court looks at:

> 1. Whether the state statutes and case law view the agency as an arm of the state;
> 2. The source of the entity's funding;
> 3. The entity's degree of local autonomy;
> 4. Whether the entity is concerned primarily with local as opposed to statewide, problems;
> 5. Whether the entity has the authority to sue and be sued in its own name; [and]
> 6. Whether the entity has the right to hold and use property.

Pet. App. 3a.

The court explained that the second factor of the test is the most important factor and was the controlling factor in this particular case. The second factor looks at whether the state would be liable for a judgment against the entity and whether it is liable in general for the entity's debts and obligations. The court found that the contract between NHIC and Texas dictated that Texas would not be liable for judgments against NHIC and pointed out that no one claimed that Texas would be liable for NHIC's general debts and obligations. *Id.* 3a-4a.

The Fifth Circuit then turned to the other five factors in the six-factor test. With regard to the first factor, it noted that no state law or state case law identified NHIC as an arm of the state. It found the third and fourth factors difficult to apply in the context of private entities but pointed out that, with regard to the third factor, although NHIC had little discretion in fulfilling its contract with the state, it was an autonomous entity. As to the fourth factor, the court noted that although NHIC fulfilled a statewide rather than local function, its ultimate concern was with its investors. Finally, the court found that the fifth and sixth factors – sue-and-be-sued authority and the right to hold and use property – weighed

against a finding that NHIC was an arm of the state. The court concluded that NHIC was not an arm of the state and was therefore not entitled to Eleventh Amendment immunity. *Id.* 5a-8a.

REASONS FOR DENYING THE WRIT

I. The Purported Circuit Splits Identified By Petitioner Are Non-Existent.

A. The Circuits Agree That Courts Should Apply Their Standard Multi-Factor Tests for Determining Whether An Entity Is An Arm Of The State To Private As Well As Public Entities.

Petitioner argues primarily that there is a "direct conflict" over whether courts should apply the same test to private entities to determine arm-of-the-state immunity as they apply to public entities. Petitioner contends that the Fifth and Ninth Circuits apply the same inquiry but that the Eleventh Circuit has "expressly refused to apply its public entity analysis to private corporate entities." Pet. 8. In truth, however, the Eleventh Circuit, like the Fifth and Ninth Circuits, applies the same test to determine whether a private or public entity is an arm of the state for Eleventh Amendment purposes, and there is thus no circuit split.

Petitioner's claim of a circuit conflict on this issue rests entirely on its mischaracterization of one Eleventh Circuit case, *Shands Teaching Hospital and Clinics, Inc. v. Beech Street Corp.*, 208 F.3d 1308 (11th Cir. 2000). In *Shands*, a hospital sued the private, third-party administrator of a state employee health insurance program and its subcontractor, a national

managed care company, asserting that it had not been paid for medical services provided. The Eleventh Circuit analyzed whether the corporations were entitled to Eleventh Amendment immunity. It explained that it used a multi-factor test to determine whether an entity is entitled to Eleventh Amendment immunity, considering "how state law defines the entity," "what degree of control the State maintains over the entity," "from where the entity derives its funds and who is responsible for judgments against the entity." *Id.* at 1311.

Petitioner contends that the Eleventh Circuit then held that the standard multi-factor test does not apply when the entities in question are private rather than public. Pet. 8. However, the Eleventh Circuit did no such thing. Rather, the court simply explained that, in applying the standard test, it is necessary to look at the entity in the context of the functions the entity fulfilled when it committed the actions for which it is being sued. *See Shands*, 208 F.3d at 1311 ("The pertinent inquiry is not into the nature of a corporation's status in the abstract, but its function or role in a particular context."). Thus, for example, instead of looking at the control the state had over the third-party administrator's business in general, the court looked at the control the state had over the corporation's administration of the state employee health program.

The Eleventh Circuit then applied its standard multi-factor test to the corporations in their roles as third-party administrator and subcontractor. It pointed out that state laws and contracts considered the corporations to be representatives of the state when running the employee health insurance program, that the state maintained control over the corporations' administration of the program, and that the program was funded through legislative appropriations. Then, like the Fifth Circuit, the Eleventh Circuit emphasized the

factor that considers the state's responsibility for judgments against the corporations. *See id.* at 1311-12 ("The dispositive question for Eleventh Amendment purposes is whether a judgment against [the corporations] would implicate the state treasury or interfere with the administration of the state group insurance program, or whether the claims constitute a private cause of action, arising out of tort or contract, for which [the corporations] would be financially responsible.").[1] In going through the factors, the Eleventh Circuit stressed that cases that found private entities entitled to Eleventh Amendment immunity did not provide those entities with all-purpose immunity, but rather found them to be immune only when they were acting in their roles as agents of the state. *Id.* at 1311.

Finally, the Eleventh Circuit considered each of the claims in the case individually. With regard to the first claim, the hospital argued that certain services it provided were "covered services" under the plan. The court pointed out that under state laws and contracts the state retained ultimate authority over coverage determinations, even allowing coverage denials to be appealed to the state, and that a judgment against the private entities would have an effect on the state treasury because the increased payouts for services found to be "covered services" would come from the state treasury fund. The court

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[1]Although Petitioner now selectively quotes this line from *Shands* to argue that *Shands* created a new test for private entities, Pet. 8, in its brief before the Fifth Circuit, it quoted this line only as part of its overall analysis of the state treasury factor of the Fifth Circuit's standard six-factor test. *See* Brief for Appellee National Heritage Insurance Company at 23, *United States ex rel. Barron v. Deloitte & Touche, L.L.P.*, No. 03-50507 (5th Cir.)

therefore found the entities entitled to immunity and dismissed the claim. *Id.* at 1312. With regard to the second claim, the hospital asserted it was due increased payments for certain services because the plan had not made the payments within 30 days. The court found that this claim, too, would implicate state funds because "payment for medical services rendered is an obligation of the state." *Id.* at 1313. It therefore dismissed that claim as well.

Contrary to Petitioner's assertions that *Shands* created a new test for private entities, the approach the Eleventh Circuit took in *Shands* is the exact approach it takes in deciding whether public entities are arms of the state. In *Manders v. Lee*, 338 F.3d 1304 (11th Cir. 2003) (en banc), *cert. denied*, 540 U.S. 1107 (2004), for example, the court considered whether a sheriff, acting in his official party, was an arm of the state for Eleventh Amendment purposes. Citing *Shands*, the court first explained that "whether a defendant is an 'arm of the state' must be assessed in light of the particular function in which the defendant was engaged when taking the actions out of which liability is asserted to arise." *Id.* at 1308. Because the sheriff was being sued for excessive use of force, the "particular functions at issue [were the sheriff's] force policy at the jail and the training and disciplining of his deputies in that regard." *Id.* at 1308-09. Then, again citing *Shands*, the court set forth its multi-factor test and proceeded to apply the four factors to the facts of the case. *See also Abusaid v. Hillsborough County Bd. of County Comm'rs*, 2005 WL 858296, at *4 (11th Cir. April 15, 2005) (explaining, in a case involving a public entity, that "the arm of the state determination must be made on a function-by-function basis").

In short, just as in the Fifth and Ninth Circuits, the test the Eleventh Circuit uses for determining whether a private

entity is an arm of the state is the same test it uses for determining whether a public entity is an arm of the state. Thus, the circuit split claimed by Petitioner does not exist.

B. The Decision Below Properly Distinguished *Shands*.

Petitioner also contends that the test used by the Fifth Circuit in the decision below to determine whether NHIC was an arm of the state conflicts with the test used by the Eleventh Circuit to determine whether a private entity is an arm of the state. Pet. 9, 18. In making this argument, Petitioner once again relies solely on *Shands*. However, the decision below specifically distinguished *Shands*, explaining why the *Shands* court reached a decision that, on first glance, may look contrary to the Fifth Circuit's holding.

In *Shands* and the decision below, the Eleventh and Fifth Circuits reached different results as to whether the entities under consideration were arms of the state: *Shands* determined that the corporations at issue in that case were arms of the state, whereas the Fifth Circuit determined that NHIC was not. As the Fifth Circuit explained, however, there is a significant difference between NHIC and the entities at issue in *Shands*: "[I]n *Shands*, [the state] would have been legally liable for any judgment rendered. By contrast, NHIC has not shown that Texas would bear any legal liability for any damages assessed against NHIC in this case." Pet. App. 12a-13a. Because the state's liability for judgments against the private entity is given particular attention in the tests used by both the Fifth and Eleventh Circuits – and in the test used by this Court, *see Regents v. Doe*, 519 U.S. 425, 430-31 (1997) – the importance of this difference cannot be overstated. Furthermore, by pointing out this difference, the Fifth Circuit suggested that, like

the Eleventh Circuit, it might have considered the corporations in *Shands* to be arms of the state. There is thus no conflict between *Shands* and the decision below.

C. The Circuits All Use Essentially The Same Test For Determining Whether An Entity Is An Arm Of The State.

Unable to cite any cases that actually conflict with the decision below, Petitioner attempts to paint a picture of mass confusion among the circuits on the general question of how to determine whether an entity is an arm of the state. However, the cases cited by Petitioner all use essentially identical tests to answer that question.

First, Petitioner contends that recent decisions by the Fourth and Sixth Circuits demonstrate a conflict. In *Cash v. Granville County Board of Education*, 242 F.3d 219, 223 (4th Cir. 2001), the Fourth Circuit found that the "principal factor" in deciding whether an entity is an arm of the state "is whether a judgment against the governmental entity would have to be paid from the State's treasury." It noted that the state treasury factor is dispositive when the state is liable for a judgment against the entity, but that other factors should also be considered when the state is found not to be liable for judgments against the entity. The other factors listed by the Fourth Circuit were the degree of control exercised by the state, whether the entity's concerns are statewide or local, and how state law treats the entity. *Id.*

Petitioner claims that the *Granville* test is "dramatically different," Pet. 12, from the test used by the Sixth Circuit in *Ernst v. Roberts*, 379 F.3d 373 (6th Cir. 2004), *reh'g granted* (Nov. 17, 2004). To begin with, the Sixth Circuit has vacated

its decision in *Ernst* and agreed to rehear the case en banc. Moreover, in *Ernst*, the Sixth Circuit, like the Fourth Circuit, held that the state treasury factor is the most significant factor in determining whether an entity is an arm of the state. *Id.* at 382. It then declined to decide the significance of factors other than the state treasury factor, noting that "it is undisputed that there is sufficient evidence and legal authority to support a conclusion as to state treasury liability, and the other factors do not align together to counter the state treasury liability analysis." *Id.* at 383. The court recognized the possibility, however, that "in cases in which it appeared that there were no potential state treasury liability, but all or almost all of the other factors clearly indicated that the agency was akin to an arm of the state, perhaps immunity would apply." *Id.* In other words, the difference between *Granville* and *Ernst* – the difference Petitioner calls "dramatic[]" – is that whereas the Fourth Circuit explicitly found that the state treasury factor could be overcome by other factors when the state treasury would not be affected by a judgment against the entity, the Sixth Circuit noted the possibility of such an outcome, but did not reach the issue.

Petitioner next asserts that the test applied by the Fifth Circuit in the decision below "could not be more divergent from the one employed by the Fourth Circuit" in *Granville*. Pet. 12. However, both the Fourth and Fifth Circuits found that the state treasury factor is the most important factor in determining whether an entity is an arm of the state, and both circuits then proceeded to consider other, similar factors. Although there are minor differences in the multi-factor tests used by the two circuits – for example, the Fifth Circuit specifies in more detail the ways in which state-law treatment of the entity might affect whether the entity is an arm of the state and thus employs a six-factor test where the fourth circuit uses a four-factor test – it is

difficult to see any substantive conflict between the Fourth and Fifth Circuits' approaches.

Finally, Petitioner mentions the tests used by the Second and Tenth Circuits, as part of its argument that, "from circuit to circuit, an entity may face markedly different requirements to invoke arm of the state immunity." Pet. 14. However, the tests used in the Second and Tenth Circuits are, in fact, remarkably similar to tests used in the other cases cited by Petitioner. In *McGinty v. New York*, 251 F.3d 84 (2d Cir. 2001), the Second Circuit recited six factors: how the entity's documents of origins refer to it, how its governing members are appointed, how it is funded, whether its role is traditionally undertaken by state or local government, whether the state has veto power over its actions, and whether the state is responsible for the entity's financial obligations. If these factors point in different directions, and if the matter does not become clear after looking at whether a suit against the entity would threaten the state's integrity and expose its treasury to risk, concern for the state's treasury controls. *Id.* at 95-96. Like its sister circuits, the Second Circuit stresses that "'the vulnerability of the state's purse [is] the most salient factor.'" *Id.* at 100 (quoting *Hess,* 513 U.S. at 48). In the Tenth Circuit, the court examines "the degree of autonomy given to the agency, as determined by the characterization of the agency by state law and the extent of guidance and control exercised by the state" and "the extent of financing the agency receives independent of the state treasury and its ability to provide for its own financing." *Sturdevant v. Paulsen*, 218 F.3d 1160, 1164 (10th Cir. 2000) (internal citation omitted). It also views state treasury liability as a particularly important factor. *See id.*

In short, all of these circuits use a multi-factor analysis for determining whether an entity is an arm of the state. All

look at the entity's status under state law, the state's control over the entity, and the effect of a judgment against the entity on the state treasury. All place particular stress on the state treasury factor. Although the circuits describe their tests somewhat differently, there is no meaningful circuit split.

II. The Fifth Circuit's Test For Determining Whether An Entity Is An Arm Of The State Does Not Conflict With This Court's Precedent.

Petitioner claims that the Fifth Circuit's approach in the decision below conflicts with this Court's jurisprudence. Contrary to Petitioner's contentions, however, the Fifth Circuit's analysis for determining whether an entity is an arm of the state for Eleventh Amendment purposes is entirely consistent with this Court's precedents.

The decision below followed this Court's analysis in *Hess,* 513 U.S. 30. There, this Court considered whether the Port Authority Trans-Hudson Corporation, an enterprise created by a bi-state compact, was an arm of the state. The Court examined a number of factors, including indicators of state and local control, whether statutory and case law considered the entity a state agency, whether the entity's functions were state or local, whether the state was financially responsible for the entity, and whether the state bore liability for the entity's debts. *Id.* at 44-46. After finding that these factors pointed in different directions, the Court noted that the "Courts of Appeals have recognized the vulnerability of the State's purse as the most salient factor in Eleventh Amendment determinations." *Id.* at 48. It went on to explain that the proper focus, in determining whether an entity is an arm of the state, should be on whether "the State [is] in fact obligated to bear and pay the resulting indebtedness of the enterprise[.] When the answer is 'No' –

both legally and practically' – then the Eleventh Amendment's core concern is not implicated." *Id.* at 51; *see also Regents v. Doe*, 519 U.S. 425, 430 (1997) (explaining that, in *Hess*, the Court "focused particular attention on the fact that 'both legally and practically' neither of the relevant States would have been obligated to pay a judgment obtained against the bistate entity"). In other words, this Court applied a multi-factor test, placing the most emphasis on whether the state would be liable for a judgment obtained against the entity. This is exactly the approach taken by the Fifth Circuit below, and by all the other circuits as well.[2]

Emphasizing the language in *Hess* that the proper focus of the inquiry is whether the state will be legally or *practically* obligated to bear an entity's debts, Petitioner asserts that the Fifth Circuit should have looked not only at whether Texas would be legally liable for a judgment against NHIC, but at

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[2]Petitioner is incorrect in asserting that the Fifth Circuit "in effect, create[d] a one-factor test for corporate entities," Pet. 14, that focuses exclusively on whether the entity has an indemnity agreement with the state. Although the Fifth Circuit did mention NHIC's agreement to indemnify Texas, it found the agreement significant because the agreement "conclusively establishes that Texas will suffer *no legal liability* for any damages assessed against NHIC." Pet. App. 4a (emphasis in original). In other words, the court focused not on whether there happened to be an indemnity agreement between the state and NHIC, but on whether there was any possibility that the state would be held liable for a judgment against NHIC. In addition, the Fifth Circuit proceeded to analyze NHIC under the other five factors in its six-factor test for determining whether an entity is an arm of the state. *Id.* 5a-8a.

whether, somewhere down the road, a judgment against NHIC may have some sort of effect on the state treasury. It contends that a judgment against NHIC would have a practical effect on the state treasury because it would cause NHIC to charge more for its services.

Petitioner's narrow focus on the word "practically" causes it to lose sight of the fact that this Court's focus is on whether a state will be *obligated*, legally or practically, to pay a judgment obtained against an entity. NHIC may choose to raise its rates in anticipation of being found liable for violations of federal law, and Texas may choose to continue procuring NHIC's services even after it raises its rates. However, a state's decision to renew a contract at a higher rate is not equivalent to the state having an *obligation* to pay a judgment obtained against the contractor.

Moreover, in *Regents v. Doe*, 519 U.S. 425, this Court firmly rejected focusing on the ultimate economic impact of denying an entity immunity and instead looked to whether the state would be liable for a judgment obtained against the entity. In *Regents*, the Court considered whether a state instrumentality could invoke Eleventh Amendment immunity when the federal government had agreed to indemnify the instrumentality against the costs of litigation. The Court held that the state instrumentality had immunity even though, because the federal government was going to indemnify the state, a finding of liability against the state instrumentality would not have affected the state treasury at all. In reaching that conclusion, the Court made clear that the inquiry was not about whether a finding of liability would have a practical effect on the state treasury. Instead, the Court found that it was the state's "potential legal liability" that was relevant. *Id.* at 431. In focusing on whether Texas would be legally liable for a

judgment against NHIC instead of on whether the decision would have a practical impact on the state treasury, the Fifth Circuit was directly following this Court's guidelines.[3]

Finally, even if this Court did apply a test that looked at the practical effects of a judgment against NHIC on the state treasury, the state treasury factor still would not weigh in NHIC's favor. Since the events that prompted this lawsuit, Texas has stopped contracting with NHIC to administer its Medicaid program. Therefore, there is no possibility that the state would, even in a purely practical way, "bear and pay the resulting indebtedness" of a judgment against NHIC. *Hess*, 513 U.S. at 51.

This Court has identified two rationales for Eleventh Amendment immunity: "to preven[t] federal-court judgments that must be paid out of a State's treasury," and "to avoid the indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties." *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 58 (1996) (internal citations and quotation marks omitted). "When indicators of immunity

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[3]Petitioner claims that, "since the decisions of this Court in *Hess* and *Regents*," Pet. 19, circuit courts have developed state treasury analyses that focus on the practical effects of a judgment instead of on direct liabilities faced by states. However, Petitioner cites only two cases, neither of which supports its position. First, Petitioner cites *Shands*, in which, as discussed above, the state would have been legally liable for certain payments if judgment were entered against the private entities. The other case cited by Petitioner, *Ristow v. South Carolina Ports Authority*, 58 F.3d 1051 (4th Cir. 1995), was decided *before* this Court's decision in *Regents*.

point in different directions, the Eleventh Amendment's twin reasons for being remain our prime guide." *Hess*, 513 U.S. at 47. Here, Respondents' qui tam action against NHIC implicates neither of the concerns underpinning Eleventh Amendment immunity. The contract between NHIC and the state dictated that NHIC would pay its own judgment. And requiring a private, corporate entity to respond to complaints in court would not affect Texas's dignity or integrity. Thus, the twin rationales for Eleventh Amendment immunity support the Fifth Circuit's determination that NHIC is not an arm of the state.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully Submitted,

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